

[JOINT COMMITTEE PRINT]

**GENERAL EXPLANATION OF  
TAX LEGISLATION  
ENACTED IN THE 113TH CONGRESS**

---

PREPARED BY THE STAFF  
OF THE  
JOINT COMMITTEE ON TAXATION



MARCH 2015

**GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 113TH CONGRESS**

[JOINT COMMITTEE PRINT]

**GENERAL EXPLANATION OF  
TAX LEGISLATION  
ENACTED IN THE 113TH CONGRESS**

---

PREPARED BY THE STAFF  
OF THE  
JOINT COMMITTEE ON TAXATION



MARCH 2015

---

U.S. GOVERNMENT PUBLISHING OFFICE

93-497

WASHINGTON : 2015

JCS-1-15



## SUMMARY CONTENTS

---

	Page
Part One: An Act to Amend the Internal Revenue Code of 1986 to Include Vaccines Against Seasonal Influenza Within the Definition of Taxable Vaccines (Public Law 113–15) .....	3
Part Two: An Act to Rename Section 219(c) of the Internal Revenue Code of 1986 as the Kay Bailey Hutchison Spousal IRA (Public Law 113–22) .....	5
Part Three: Fallen Firefighters Assistance Tax Clarification Act of 2013 (Public Law 113–63) .....	7
Part Four: Philippines Charitable Giving Assistance Act (Public Law 113–92) .....	8
Part Five: Gabriella Miller Kids First Research Act (Public Law 113–94) .....	10
Part Six: Cooperative and Small Employer Charity Pension Flexibility Act (Public Law 113–97) .....	12
Part Seven: Revenue Provisions of the Highway and Transportation Funding Act of 2014 (Public Law 113–159) .....	29
Part Eight: Tribal General Welfare Exclusion Act of 2014 (Public Law 113–168) .....	40
Part Nine: Consolidated and Further Continuing Appropriations Act, 2015 (Public Law 113–235) .....	42
Part Ten: An Act to Amend Certain Provisions of the FAA Modernization and Reform Act of 2012 (Public Law 113–243) .....	114
Part Eleven: Grand Portage Band Per Capita Adjustment Act (Public Law 113–290) .....	118
Part Twelve: Tax Increase Prevention Act of 2014 and the Stephen Beck, Jr., Achieving a Better Life Experience Act of 2014 (Public Law 113–295) .....	119



## CONTENTS

	Page
<b>Introduction</b> .....	1
<b>Part One: An Act to Amend the Internal Revenue Code of 1986 to Include Vaccines Against Seasonal Influenza Within the Definition of Taxable Vaccines (Public Law 113-15)</b> .....	3
A. Addition of Vaccines Against Seasonal Influenza To List of Taxable Vaccines (sec. 1 of the Act and sec. 4132(a)(1) of the Code) .....	3
<b>Part Two: An Act to Rename Section 219(c) of the Internal Revenue Code of 1986 as the Kay Bailey Hutchison Spousal IRA (Public Law 113-22)</b> .....	5
A. Kay Bailey Hutchison Spousal IRA (sec. 1 of the Act and sec. 219(c) of the Code) .....	5
<b>Part Three: Fallen Firefighters Assistance Tax Clarification Act of 2013 (Public Law 113-63)</b> .....	7
A. Payments by Charitable Organizations With Respect to Certain Firefighters Treated as Exempt Payments (sec. 2 of the Act) .....	7
<b>Part Four: Philippines Charitable Giving Assistance Act (Public Law 113-92)</b> .....	8
A. Acceleration of Income Tax Benefits for Charitable Cash Contributions for Relief of Victims of Typhoon Haiyan in the Philippines (sec. 2 of the Act) .....	8
<b>Part Five: Gabriella Miller Kids First Research Act (Public Law 113-94)</b> .....	10
A. Termination of Taxpayer Financing of Political Party Conventions; Use of Funds for Pediatric Research Initiative (sec. 2 of the Act and sec. 9008 of the Code) .....	10
<b>Part Six: Cooperative and Small Employer Charity Pension Flexibility Act (Public Law 113-97)</b> .....	12

	Page
A. Cooperative and Small Employer Charity Pension Plans (secs. 3, 101–103 and 201–203 of the Act, new secs. 414(y) and 433 of the Code, and new secs. 210(f) and 306 of ERISA) .....	12
B. Election to Cease Treatment as an Eligible Charity Plan (sec. 103(b) and (d) of the Act, sec. 430 of the Code and sec. 303 of ERISA) ...	22
C. Deemed Election for Church Plans (sec. 103(c) and (d) of the Act and sec. 410(d) of the Code)	25
D. Transparency in Annual Reports and Notices (secs. 3 and 104 of the Act and secs. 101(d), 101(f) and 103 of ERISA) .....	27
E. Sponsor Education and Assistance (secs. 3 and 105 of the Act and sec. 4004 of ERISA) .....	28
<b>Part Seven: Revenue Provisions of the Highway and Transportation Funding Act of 2014 (Public Law 113–159)</b> .....	29
A. Extension of Highway Trust Fund Expenditure Authority (sec. 2001 of the Act and secs. 9503, 9504 and 9508 of the Code) .....	29
B. Funding of the Highway Trust Fund (sec. 2002 of the Act and secs. 9503(f) and 9508(c) of the Code) .....	30
C. Pension Funding Stabilization (sec. 2003 of the Act and secs. 430 and 436 of the Code) .....	32
D. Extension of Customs User Fees (sec. 2004 of the Act and sec. 58c(j)(3) of Title 19 of the United States Code) .....	38
<b>Part Eight: Tribal General Welfare Exclusion Act of 2014 (Public Law 113–168)</b> .....	40
A. Indian General Welfare Benefits (sec. 2 of the Act and new sec. 139E of the Code) .....	40
<b>Part Nine: Consolidated and Further Continuing Appropriations Act, 2015 (Public Law 113–235)</b> .....	42
<b>Division M—Expatriate Health Coverage Clarification Act of 2014</b> .....	42
A. Treatment of Expatriate Health Plans under ACA (sec. 3 of the Act) .....	42
<b>Division N—Other Matters</b> .....	58



## VII

	Page
A. Tax Technical Correction to Treatment of Certain Health Organizations (sec. 2 of the Act and sec. 833 of the Code) .....	58
<b>Division O—The Multiemployer Pension Reform Act of 2014</b> .....	59
A. Amendments to Pension Protection Act of 2006 .....	59
1. Repeal of sunset of PPA funding rules (sec. 101 of the Act, sec. 221 of the Pension Protection Act of 2006, secs. 431–432 of the Code and secs. 304–305 of ERISA) .....	59
2. Election to be in critical status (sec. 102 of the Act, sec. 432 of the Code and sec. 305 of ERISA) .....	63
3. Clarification of rule for emergence from critical status (sec. 103 of the Act, sec. 432 of the Code and sec. 305 of ERISA) ...	66
4. Endangered status not applicable if no additional action is required (sec. 104 of the Act, sec. 432 of the Code and sec. 305 of ERISA) .....	68
5. Correct endangered status funding improvement plan target funded percentage (sec. 105 of the Act, sec. 432 of the Code and sec. 305 of ERISA) .....	70
6. Conforming endangered status and critical status rules during funding improvement and rehabilitation plan adoption periods (secs. 106, 109(a)(2)(B) and 109(b)(2)(B) of the Act, sec. 432 of the Code and sec. 305 of ERISA) .....	71
7. Corrective plan schedules when parties fail to adopt in bargaining (sec. 107 of the Act, sec. 432 of the Code and sec. 305 of ERISA) .....	75
8. Repeal of reorganization rules for multiemployer plans (sec. 108 of the Act, secs. 418–418E of the Code and secs. 4241–4245 of ERISA) .....	76
9. Disregard of certain contribution increases for withdrawal liability purposes (sec. 109 of the Act, sec. 432 of the Code and sec. 305 of ERISA) .....	77

# VIII

	Page
10. Guarantee for preretirement survivor annuities under multiemployer pension plans (sec. 110 of the Act and sec. 4022A of ERISA) .....	80
11. Required disclosure of multiemployer plan information (sec. 111 of the Act and secs. 101(k) and 107 of ERISA) .....	81
B. Multiemployer Plan Mergers and Partitions .....	83
1. Mergers (sec. 121 of the Act and sec. 4231 of ERISA) .....	83
2. Partitions of eligible multiemployer plans (sec. 122 of the Act and sec. 4233 of ERISA) .....	84
C. Strengthening the Pension Benefit Guaranty Corporation (sec. 131 of the Act and sec. 4006(a)(3) of ERISA) .....	88
D. Remediation Measures for Deeply Troubled Plans (sec. 201 of the Act, sec. 432 of the Code and sec. 305 of ERISA) .....	89
<b>Division P—Other Retirement-Related Modifications ...</b>	<b>104</b>
A. Substantial Cessation of Operations (sec. 1 of the Act and sec. 4062(e) of ERISA) .....	104
B. Clarification of the Normal Retirement Age (sec. 2 of the Act, sec. 411 of the Code, and sec. 204 of ERISA) .....	110
C. Application of Cooperative and Small Employer Charity Pension Plan Rules to Certain Charitable Employers Whose Primary Exempt Purpose is Providing Services with Respect to Children (sec. 3 of the Act, sec. 414(y) of the Code, and sec. 210(f) of ERISA) .....	112
<b>Part Ten: An Act To Amend Certain Provisions of the FAA Modernization and Reform Act of 2012 (Public Law 113–243) .....</b>	<b>114</b>
A. Rollover of Amounts Received in Airline Carrier Bankruptcy (sec. 1 of the Act and sec. 1106 of the FAA Modernization and Reform Act of 2012) .....	114
<b>Part Eleven: Grand Portage Band Per Capita Adjustment Act (Public Law 113–290) .....</b>	<b>118</b>

	Page
A. Equal Treatment of Certain Per Capita Income For Purposes of Federal Assistance (sec. 2 of the Act) .....	118
<b>Part Twelve: Tax Increase Prevention Act of 2014 and the Stephen Beck, Jr., Achieving a Better Life Expe- rience Act of 2014 (Public Law 113–295) .....</b>	<b>119</b>
<b>Division A—Tax Increase Prevention Act of 2014 .....</b>	<b>119</b>
<b>TITLE I—CERTAIN EXPIRING PROVISIONS .....</b>	<b>119</b>
A. Subtitle A—Individual Tax Extenders .....	119
1. Extension of deduction for certain expenses of elementary and secondary school teach- ers (sec. 101 of the Act and sec. 62(a)(2)(D) of the Code) .....	119
2. Extension of exclusion from gross income of discharges of acquisition indebtedness on principal residences (sec. 102 of the Act and sec. 108 of the Code) .....	120
3. Extension of parity for employer-provided mass transit and parking benefits (sec. 103 of the Act and 132(f) of the Code) .....	122
4. Extension of mortgage insurance premiums treated as qualified residence interest (sec. 104 of the Act and sec. 163 of the Code) .....	123
5. Extension of deduction for State and local general sales taxes (sec. 105 of the Act and sec. 164 of the Code) .....	124
6. Extension of special rule for contributions of capital gain real property made for con- servation purposes (sec. 106 of the Act and sec. 170(b) of the Code) .....	126
7. Extension of above-the-line deduction for qualified tuition and related expenses (sec. 107 of the Act and sec. 222 of the Code) .....	129
8. Extension of tax-free distributions from in- dividual retirement plans for charitable purposes (sec. 108 of the Act and sec. 408(d)(8) of the Code) .....	130
B. Subtitle B—Business Tax Extenders .....	134

	Page
1. Extension of research credit (sec. 111 of the Act and sec. 41 of the Code) .....	134
2. Extension of temporary minimum low-income housing tax credit rate for non-Federally subsidized buildings (sec. 112 of the Act and sec. 42 of the Code) .....	137
3. Extension of military housing allowance exclusion for determining whether a tenant in certain counties is low-income (sec. 113 of the Act and secs. 42 and 142 of the Code) .....	138
4. Extension of Indian employment tax credit (sec. 114 of the Act and sec. 45A of the Code) .....	139
5. Extension of new markets tax credit (sec. 115 of the Act and sec. 45D of the Code) ..	140
6. Extension of railroad track maintenance credit (sec. 116 of the Act and sec. 45G of the Code) .....	143
7. Extension of mine rescue team training credit (sec. 117 of the Act and sec. 45N of the Code) .....	144
8. Extension of employer wage credit for employees who are active duty members of the uniformed services (sec. 118 of the Act and sec. 45P of the Code) .....	145
9. Extension of work opportunity tax credit (sec. 119 of the Act and secs. 51 and 52 of the Code) .....	146
10. Extension of qualified zone academy bonds (sec. 120 of the Act and sec. 54E of the Code) .....	152
11. Extension of classification of certain race horses as three-year property (sec. 121 of the Act and sec. 168 of the Code) .....	154
12. Extension of 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements (sec. 122 of the Act and sec. 168 of the Code) .....	155

	Page
13. Extension of seven-year recovery period for motorsports entertainment complexes (sec. 123 of the Act and sec. 168 of the Code) .....	158
14. Extension of accelerated depreciation for business property on an Indian reservation (sec. 124 of the Act and sec. 168(j) of the Code) .....	159
15. Extension of bonus depreciation (sec. 125 of the Act and sec. 168(k) of the Code) .....	160
16. Extension of enhanced charitable deduction for contributions of food inventory (sec. 126 of the Act and sec. 170 of the Code) .....	165
17. Extension of increased expensing limitations and treatment of certain real property as section 179 property (sec. 127 of the Act and sec. 179 of the Code) .....	167
18. Extension of election to expense mine safety equipment (sec. 128 of the Act and sec. 179E of the Code) .....	169
19. Extension of special expensing rules for certain film and television productions (sec. 129 of the Act and sec. 181 of the Code) .....	170
20. Extension of deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (sec. 130 of the Act and sec. 199 of the Code) ...	171
21. Extension of modification of tax treatment of certain payments to controlling exempt organizations (sec. 131 of the Act and sec. 512 of the Code) .....	172
22. Extension of treatment of certain dividends of regulated investment companies (sec. 132 of the Act and sec. 871(k) of the Code) .....	173
23. Extension of RIC qualified investment entity treatment under FIRPTA (sec. 133 of the Act and secs. 897 and 1445 of the Code) .....	174
24. Extension of subpart F exception for active financing income (sec. 134 of the Act and secs. 953 and 954 of the Code) .....	175

	Page
25. Extension of look-thru treatment of payments between related controlled foreign corporations under foreign personal holding company rules (sec. 135 of the Act and sec. 954(c)(6) of the Code) .....	178
26. Extension of exclusion of 100 percent of gain on certain small business stock (sec. 136 of the Act and sec. 1202 of the Code) .	179
27. Extension of basis adjustment to stock of S corporations making charitable contributions of property (sec. 137 of the Act and sec. 1367 of the Code) .....	180
28. Extension of reduction in S corporation recognition period for built-in gains tax (sec. 138 of the Act and sec. 1374 of the Code) .....	181
29. Extension of empowerment zone tax incentives (sec. 139 of the Act and sec. 1391 of the Code) .....	183
30. Extension of temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands (sec. 140 of the Act and sec. 7652(f) of the Code) ....	189
31. Extension of American Samoa Economic Development Credit (sec. 141 of the Act and sec. 119 of Pub. L. No. 109-432) .....	190
C. Subtitle C—Energy Tax Extenders .....	192
1. Extension of credit for nonbusiness energy property (sec. 151 of the Act and sec. 25C of the Code) .....	192
2. Extension of second generation biofuel producer credit (sec. 152 of the Act and sec. 40(b)(6) of the Code) .....	194
3. Extension of incentives for biodiesel and renewable diesel (secs. 153 of the Act and secs. 40A, 6426 and 6427(e) of the Code) ..	195
4. Extension of credit for the production of Indian coal facilities placed in service before 2009 (sec. 154 of the Act and sec. 45(e)(10) of the Code) .....	198

### XIII

	Page
5. Extension of credits with respect to facilities producing energy from certain renewable resources (sec. 155 of the Act and secs. 45 and 48 of the Code) .....	198
6. Extension of credit for energy-efficient new homes (sec. 156 of the Act and sec. 45L of the Code) .....	199
7. Extension of special allowance for second generation biofuel plant property (sec. 157 of the Act and sec. 168(l) of the Code) .....	200
8. Extension of energy efficient commercial buildings deduction (sec. 158 of the Act and sec. 179D of the Code) .....	202
9. Extension of special rule for sales or dispositions to implement FERC or State electric restructuring policy for qualified electric utilities (sec. 159 of the Act and sec. 451(i) of the Code) .....	204
10. Extension of excise tax credits relating to certain fuels (sec. 160 of the Act and sec. 6426 and 6427(e) of the Code) .....	206
11. Extension of credit for alternative fuel vehicle refueling property (sec. 161 of the Act and sec. 30C of the Code) .....	207
D. Subtitle D—Extenders Relating to Multiemployer Defined Benefit Pension Plans .....	209
1. Multiemployer defined benefit plans (secs. 171–172 of the Act and sec. 221(c) of the Pension Protection Act of 2006, secs. 431–432 of the Code, and secs. 304–305 of ERISA) .....	209
TITLE II—TECHNICAL CORRECTIONS .....	209
A. Tax Technical Corrections (secs. 201–220 of the Act) .....	209
B. Deadwood Provisions (sec. 221 of the Act) .....	217
TITLE III—JOINT COMMITTEE ON TAXATION .....	217
A. Increased Refund and Credit Threshold for Joint Committee on Taxation Review of C Corporation Return (sec. 301 of the Act and sec. 6405 of the Code) .....	217

	Page
<b>Division B—Stephen Beck, Jr., Achieving a Better Life Experience Act of 2014 or the Stephen Beck, Jr., Able Act of 2014</b> .....	218
<b>TITLE I—QUALIFIED ABLE PROGRAMS</b> .....	218
A. Qualified Able Programs (secs. 101–105 of the Act and section 529 and new section 529A of the Code) .....	218
<b>TITLE II—OFFSETS</b> .....	226
A. Modification Relating to Inland Waterways Trust Fund Financing Rate (sec. 205 of the Act and sec. 4042 of the Code) .....	226
B. Certified Professional Employer Organizations (sec. 206 of the Act and new secs. 3511, 6652(n), and 7705 of the Code) .....	227
C. Exclusion of Dividends from Controlled Foreign Corporations from the Definition of Personal Holding Company Income for Purposes of the Personal Holding Company Rules (sec. 207 of the Act and sec. 543 of the Code) .....	237
D. Inflation Adjustment for Certain Civil Penalties Under the Internal Revenue Code (sec. 208 of the Act and secs. 6651, 6652(c), 6695, 6698, 6699, 6721, and 6722 of the Code) .....	239
E. Increase Continuous Levy Authority on Payments to Medicare Providers and Suppliers (sec. 209 of the Act and sec. 6331 of the Code) .....	241
<b>Appendix: Estimated Budget Effects of Tax Legislation Enacted in the 113th Congress</b> .....	243



## INTRODUCTION

This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation in consultation with the staffs of the House Committee on Ways and Means and the Senate Committee on Finance, provides an explanation of tax legislation enacted in the 113th Congress. The explanation follows the chronological order of the tax legislation as signed into law.

For each provision, the document includes a description of present law, explanation of the provision, and effective date. Present law describes the law in effect immediately prior to enactment and does not reflect changes to the law made by the provision or by subsequent legislation. Reasons for change are included based on Committee report language for provisions reported by a Committee. For provisions enacted in bills that went directly to the House and Senate floors without a Committee report, no reasons for change are included in this document.

In a case where a Committee report accompanies a bill, this document is based on the language of the report. For a bill with no Committee report but with a contemporaneous technical explanation prepared and published by the staff of the Joint Committee on Taxation, this document is based on the language of the explanation.

Section references are to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

Part One is an explanation of the provisions of An Act to amend the Internal Revenue Code of 1986 to include vaccines against seasonal influenza within the definition of taxable vaccines (Pub. L. No. 113–15).

Part Two is an explanation of the provisions of An Act to rename section 219(c) of the Internal Revenue Code of 1986 as the Kay Bailey Hutchison Spousal IRA (Pub. L. No. 113–22).

Part Three is an explanation of the provisions of the Fallen Firefighters Assistance Tax Clarification Act of 2013 (Pub. L. No. 113–63).

Part Four is an explanation of the provisions of the Philippines Charitable Giving Assistance Act (Pub. L. No. 113–92).

Part Five is an explanation of the provisions of the Gabriella Miller Kids First Research Act (Pub. L. No. 113–94).

Part Six is an explanation of the provisions of the Cooperative and Small Employer Charity Pension Flexibility Act (Pub. L. No. 113–97).

Part Seven is an explanation of the provisions of the Highway and Transportation Funding Act of 2014 (Pub. L. No. 113–159).

---

<sup>1</sup>This document may be cited as follows: Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 113th Congress (JCS–1–15), March, 2014.

Part Eight is an explanation of the provisions of the Tribal General Welfare Exclusion Act of 2014 (Pub. L. No. 113–168).

Part Nine is an explanation of the revenue provisions of Consolidated and Further Continuing Appropriations Act, 2015 (Pub. L. No. 113–235).

Part Ten is an explanation of the provisions of An Act to amend certain provisions of the FAA Modernization and Reform Act of 2012 (Pub. L. No. 113–243).

Part Eleven is an explanation of the provisions of the Grand Portage Band Per Capita Adjustment Act (Pub. L. No. 113–290).

Part Twelve is an explanation of the provisions of the Tax Increase Prevention Act of 2014 and the Stephen Beck, Jr., Achieving a Better Life Experience Act of 2014 (Pub. L. No. 113–295).

The Appendix provides the estimated budget effects of tax legislation enacted in the 113th Congress.

The first footnote in each Part gives the legislative history of the Act explained in that Part.

**PART ONE: AN ACT TO AMEND THE INTERNAL REVENUE  
CODE OF 1986 TO INCLUDE VACCINES AGAINST SEA-  
SONAL INFLUENZA WITHIN THE DEFINITION OF TAX-  
ABLE VACCINES**

**(PUBLIC LAW 113-15) <sup>2</sup>**

**A. Addition of Vaccines Against Seasonal Influenza To List  
of Taxable Vaccines (sec. 1 of the Act and sec. 4132(a)(1)  
of the Code)**

***Present Law***

Under present law, a tax is imposed on specified, taxable vaccines sold by the manufacturer, producer, or importer thereof.<sup>3</sup> Manufacturers, producers, and importers are responsible for paying 75 cents per dose of such specified, taxable vaccines upon the sale of the vaccine, but the tax does not apply if it has already been imposed on a prior sale of such vaccine.<sup>4</sup> Vaccines which include multiple, specified, and taxable vaccines are taxed cumulatively—that is, if two specified, taxable vaccines are combined, then the tax imposed is \$1.50 per dose.<sup>5</sup> Similarly, fractional doses are taxed at the same fraction of the amount of such tax imposed on a whole dose.<sup>6</sup> Doses which are used by manufacturers, producers, or importers before being sold are taxed as if the vaccine were sold by such manufacturers, producers, or importers.<sup>7</sup>

Currently, section 4132(a)(1)(N) includes any trivalent vaccine against influenza as a specified, taxable vaccine. Vaccines against influenza are changed each season to protect against the influenza viruses that research indicates will be most common during the upcoming season.<sup>8</sup> Trivalent vaccines, for example, protect against three different seasonal flu viruses; quadrivalent vaccines, on the other hand, protect against four different seasonal flu viruses.<sup>9</sup> Seasonal influenza vaccines that are not trivalent vaccines, such as quadrivalent vaccines, are not currently specified, taxable vaccines.

---

<sup>2</sup>H.R. 475. The House passed H.R. 475 on June 18, 2013. The Senate passed the bill without amendment on June 19, 2013. The President signed the bill on June 25, 2013.

<sup>3</sup>Sec. 4131. Unless otherwise specified, all section references are made to the Internal Revenue Code of 1986, as amended.

<sup>4</sup>Sec. 4132(b)(4).

<sup>5</sup>Sec. 4131(b)(2).

<sup>6</sup>Sec. 4132(c)(3).

<sup>7</sup>Sec. 4132(c)(1).

<sup>8</sup>Center for Disease Control, *Key Facts About Seasonal Flu Vaccine* (March 6, 2014), available at <http://www.cdc.gov/flu/protect/keyfacts.htm>.

<sup>9</sup>*Ibid.*

***Explanation of Provision***

The provision changes section 4132(a)(1)(N) to include any trivalent vaccine against influenza or any other vaccine against seasonal influenza.

***Effective Date***

For sales and uses, the provision is effective on or after the later of (A) the first day of the first month which begins more than four weeks after the date of enactment (June 25, 2013), or (B) the date on which the Secretary of Health and Human Services lists any vaccine against seasonal influenza (other than any vaccine against seasonal influenza listed by the Secretary prior to the date of the date of enactment) for purposes of compensation for any vaccine-related injury or death through the Vaccine Injury Compensation Trust Fund.

For deliveries, in the case of sales on or before the effective date described above for which delivery is made after such date, the delivery date shall be considered the sale date.

**PART TWO: AN ACT TO RENAME SECTION 219(C) OF THE  
INTERNAL REVENUE CODE OF 1986 AS THE KAY BAI-  
LEY HUTCHISON SPOUSAL IRA (PUBLIC LAW 113–22)**<sup>10</sup>

**A. Kay Bailey Hutchison Spousal IRA (sec. 1 of the Act and  
sec. 219(c) of the Code)**

***Present Law***

Under present law, an individual may make contributions to an individual retirement arrangement (“IRA”).<sup>11</sup> There are two basic types of IRAs: traditional IRAs, to which both deductible and non-deductible contributions may be made, and Roth IRAs, to which only nondeductible contributions may be made.

An annual limit applies to the aggregate contributions to all of an individual’s IRAs (both traditional and Roth) for a taxable year. The contribution limit is generally the lesser of a certain dollar amount (for 2013, \$5,500 or \$6,500 for an individual age 50 or older) or the individual’s compensation. Thus, generally, if an individual’s compensation for a year is less than the dollar amount, the applicable limit for that year is the amount of the individual’s compensation. An individual with no compensation for a year generally may not make any IRA contributions for that year.

Under a special rule, in the case of a married couple filing a joint return, a spouse with compensation lower than the other spouse may include compensation of the other spouse in determining his or her own IRA contribution limits.<sup>12</sup> Specifically, for this purpose, compensation of the spouse with lower compensation is the sum of (1) that spouse’s compensation, plus (2) the other spouse’s compensation reduced by any IRA contributions made by the other spouse. This rule thus allows a spouse with no compensation to make contributions up to the dollar limit by taking into account the other spouse’s compensation.

***Explanation of Provision***

The provision amends the heading of the Code section that allows a spouse to include compensation of the other spouse in determining his or her own IRA contribution limits, so that the heading reads “Kay Bailey Hutchison spousal IRA.”

---

<sup>10</sup>H.R. 2289. The House passed H.R. 2289 on June 25, 2013. The Senate passed the bill without amendment on July 11, 2013. The President signed the bill on July 25, 2013.

<sup>11</sup>Secs. 219, 408 and 408A. The principal difference between traditional and Roth IRAs is the timing of income tax inclusion. For a traditional IRA, an eligible contributor may deduct the contributions made for the year, but distributions are includible in gross income to the extent attributable to the deductible contributions and earnings on the IRA (or to the extent distributions exceed the individual’s basis attributable to nondeductible contributions). For a Roth IRA, all contributions are after-tax (that is, no deduction is allowed) but, if certain requirements are met, distributions are not includible in gross income.

<sup>12</sup>Sec. 219(c).

***Effective Date***

The provision is effective on the date of enactment (July 25, 2013).

**PART THREE: FALLEN FIREFIGHTERS ASSISTANCE TAX  
CLARIFICATION ACT OF 2013 (PUBLIC LAW 113–63) <sup>13</sup>**

**A. Payments by Charitable Organizations With Respect to  
Certain Firefighters Treated as Exempt Payments (sec. 2  
of the Act)**

***Present Law***

In general, organizations described in section 501(c)(3) are exempt from taxation. Such organizations are classified either as private foundations or public charities. Public charities include organizations that receive broad public support (sec. 509(a)(1) or sec. 509(a)(2)), supporting organizations (sec. 509(a)(3)), and organizations organized and operated for testing for public safety (sec. 509(a)(4)).

Contributions to section 501(c)(3) organizations generally are tax deductible (sec. 170). Section 501(c)(3) organizations must be organized and operated exclusively for exempt purposes and no part of the net earnings of such organizations may inure to the benefit of any private shareholder or individual. An organization is not organized or operated exclusively for one or more exempt purposes unless the organization serves a public rather than a private interest. Thus, an organization described in section 501(c)(3) generally must serve a charitable class of persons that is indefinite or of sufficient size.

***Explanation of Provision***

Under the provision, certain payments made by a public charity described in section 509(a)(1) and (a)(2) are treated as related to the purpose or function constituting the basis for the organization's exempt status, if the payments are made in good faith using a reasonable and objective formula that is consistently applied. This provision applies to payments to: (1) any firefighter who was injured as a result of the ambush of firefighters responding to an emergency on December 24, 2012, in Webster, New York; (2) the spouse of any firefighter who died as a result of such ambush; or (3) any dependent (as defined in section 152 of the Code) of any firefighter who died as a result of such ambush.

***Effective Date***

The provision applies to payments made on or after December 24, 2012, and before the later of (1) January 1, 2014, or (2) the date which is 30 days after the date of enactment (that is, 30 days after December 20, 2013).

---

<sup>13</sup> H.R. 3458. The House passed H.R. 3458 on December 12, 2013. The Senate passed the bill without amendment on December 13, 2013. The President signed the bill on December 20, 2013.

**PART FOUR: PHILIPPINES CHARITABLE GIVING  
ASSISTANCE ACT (PUBLIC LAW 113-92)<sup>14</sup>**

**A. Acceleration of Income Tax Benefits for Charitable Cash  
Contributions for Relief of Victims of Typhoon Haiyan in  
the Philippines (sec. 2 of the Act)**

***Present Law***

In general, under present law, taxpayers may claim an income tax deduction for charitable contributions. The charitable deduction generally is available for the taxable year in which the contribution is made. The tax benefit of a charitable contribution often is not apparent until the following calendar year when the taxpayer's tax return is filed and the taxpayer receives a refund or realizes a reduction in taxes owed.

A donor who claims a charitable deduction for a charitable contribution of money, regardless of amount, must maintain as a record of the contribution a bank record or a written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution.<sup>15</sup>

***Explanation of Provision***

The provision permits taxpayers to treat charitable contributions of cash made after March 25, 2014, and before April 15, 2014, as contributions made on December 31, 2013, if such contributions were for the relief of victims in areas affected by Typhoon Haiyan. Thus, the effect of the provision is to give taxpayers who make Typhoon Haiyan-related charitable contributions of cash after March 25, 2014, and before April 15, 2014, the opportunity to accelerate their tax benefit.

The provision also clarifies the recordkeeping requirement of section 170(f)(17) for monetary contributions eligible for the accelerated income tax deduction described above. With respect to such contributions, a telephone bill will also satisfy the recordkeeping requirement if it shows the name of the donee organization, the date of the contribution, and the amount of the contribution. Thus, for example, in the case of a charitable contribution made by text message and charged to a telephone or wireless account, a bill from the telecommunications company containing the relevant information will satisfy the recordkeeping requirement.

---

<sup>14</sup>H.R. 3771. The House passed H.R. 3771 on March 24, 2014. The Senate passed the bill without amendment on March 25, 2014. The President signed the bill on March 25, 2014.

<sup>15</sup>Sec. 170(f)(17).



***Effective Date***

The provision is effective on the date of enactment (March 25, 2014).

**PART FIVE: GABRIELLA MILLER KIDS FIRST RESEARCH  
ACT (PUBLIC LAW 113-94)**<sup>16</sup>

**A. Termination of Taxpayer Financing of Political Party  
Conventions; Use of Funds for Pediatric Research Initia-  
tive (sec. 2 of the Act and sec. 9008 of the Code)**

*Present Law*

Section 9008 provides a mechanism for the financing of presidential nominating conventions. The Secretary of the Treasury is required to maintain a separate account within the Presidential Election Campaign Fund for the national committee of each major party and minor party. The Secretary is required to deposit into each such committee's account the amount the committee is entitled to receive with respect to any presidential nominating convention. The deposits are drawn from amounts designated by individual taxpayers at the time of filing a Federal income tax return to be paid over to the Presidential Election Campaign Fund.

With respect to any presidential nominating convention, the national committee of a major party is entitled to receive amounts that, in the aggregate, do not exceed \$4 million (indexed for inflation). For the 2012 presidential nominating conventions, each major party was entitled to receive \$17,689,800. The national committee of a minor party generally is entitled to receive an amount that bears the same ratio to the major-party amount as (1) the number of popular votes the minor party's presidential candidate received in the preceding presidential election bears to (2) the average number of popular votes received by major-party candidates in that election.

If, after the close of a presidential nominating convention and the payment of amounts to which a committee is entitled, money remains in the account of a national committee, the Secretary is required to transfer the remaining amounts to the Presidential Election Campaign Fund. Additional rules address the use of funds, limitations on expenditures, and the timing of payments.

*Explanation of Provision*

The provision terminates the entitlement of any major party or minor party to a payment under section 9008. All amounts in each account maintained for the national committee of a major party or minor party are to be transferred to a new fund in the Treasury to be known as the "10-Year Pediatric Research Initiative Fund." Amounts in the Fund are available only for the purpose provided

---

<sup>16</sup>H.R. 2019. The House passed H.R. 2019 on December 11, 2013. The Senate passed the bill without amendment on March 11, 2014. The President signed the bill on April 3, 2014.

in section 402A(a)(2) of the Public Health Service Act,<sup>17</sup> and only to the extent and in such amounts as are provided in advance in appropriations Acts.

The provision also makes various technical and conforming changes to sections 9006, 9009 and 9012.

***Effective Date***

The provision is effective on the date of enactment (April 3, 2014).

---

<sup>17</sup>Section 3 of the Gabriella Miller Kids First Research Act (Pub. L. No. 113–94) amends the Public Health Service Act (42 U.S.C. sec. 282) to address funding of the pediatric research initiative.

**PART SIX: COOPERATIVE AND SMALL EMPLOYER CHARITY PENSION FLEXIBILITY ACT (PUBLIC LAW 113-97)<sup>18</sup>**

**A. Cooperative and Small Employer Charity Pension Plans (secs. 3, 101-103 and 201-203 of the Act, new secs. 414(y) and 433 of the Code, and new secs. 210(f) and 306 of ERISA<sup>19</sup>)**

***Present Law***

***Defined benefit plans and minimum funding requirements***

*Types of plans*

Qualified retirement plans, including defined benefit plans, are categorized for some purposes as one of three types, based on the number of employers that maintain the plan and the type of employees covered by the plan. The three types are single-employer plans, multiple-employer plans, and multiemployer plans.

A single-employer plan is a plan maintained by one employer. For this purpose, businesses and organizations are that members of a controlled group, a group under common control, or an affiliated service group are treated as one employer (referred to as “aggregation”).<sup>20</sup> A single-employer plan may cover employees who are also covered by a collective bargaining agreement (“collectively bargained employees”), pursuant to which the plan is maintained (a “collectively bargained plan”).<sup>21</sup> An employer may maintain separate single-employer plans for collectively and noncollectively bargained employees, or they may be covered by the same plan.

A multiple-employer plan is a single plan maintained by two or more unrelated employers (that is, employers that are not treated as a single employer under the aggregation rules) and which is not a multiemployer plan (as defined below).<sup>22</sup> Multiple-employer plans are commonly maintained by employers in the same industry. A multiple-employer plan may cover collectively bargained employees or noncollectively bargained employees.

Multiemployer plans (also known as “Taft-Hartley” plans and distinct from multiple-employer plans) are plans maintained pursuant to one or more collective bargaining agreements with two or more unrelated employers and to which the employers are required to contribute under the collective bargaining agreement(s).<sup>23</sup> Multiemployer plans commonly cover collectively bargained employees in a particular industry.

<sup>18</sup>H.R. 4275. The House passed H.R. 4275 on March 24, 2014. The Senate passed the bill without amendment on March 25, 2014. The President signed the bill on April 7, 2014.

<sup>19</sup>ERISA refers to the Employee Retirement Income Security Act of 1974.

<sup>20</sup>Secs. 414(b), (c), (m) and (o).

<sup>21</sup>Treas. Reg. sec. 1.410(b)-6(d).

<sup>22</sup>Sec. 413(c) and ERISA sec. 210(a).

<sup>23</sup>Sec. 414(f) and ERISA sec. 2(37).

*Minimum funding requirements and PPA*

Defined benefit plans maintained by private employers are generally subject to minimum funding requirements under the Code and ERISA.<sup>24</sup> The employer or employers maintaining a plan may be subject to an excise tax for a failure to make required contributions unless a funding waiver is obtained.<sup>25</sup>

Before the Pension Protection Act of 2006 (“PPA”),<sup>26</sup> the basic funding rules applicable to single-employer plans, multiple-employer plans, and multiemployer plans were similar, with an additional contribution requirement, referred to as the “deficit reduction contribution” (or “DRC”) requirement, for single-employer and multiple-employer plans.<sup>27</sup> PPA replaced the funding rules for single-employer plans and multiple-employer plans with new rules, effective for plan years beginning after December 31, 2007.<sup>28</sup> However, PPA provided a delayed effective date (“PPA delayed effective date”) for certain multiple-employer plans, under which the PPA funding rules apply as of the earlier of (1) the first plan year for which the plan ceases to be an eligible cooperative plan (described below) or (2) January 1, 2017.<sup>29</sup> In the interim, as discussed below, these plans continue to be subject to the minimum funding rules in effect before PPA, with certain modifications.

The PPA delayed effective date applies to a plan that was in existence on July 26, 2005, and was an eligible cooperative plan for the plan year including that date. A plan is treated as an eligible cooperative plan for a plan year if it is maintained by more than one employer and at least 85 percent of the employers are (1) certain rural cooperatives<sup>30</sup> or (2) certain cooperative organizations that are more than 50-percent owned by agricultural producers or by cooperatives owned by agricultural producers, or organizations that are more than 50-percent owned, or controlled by, one or more of these cooperative organizations. A plan is also treated as an eligible cooperative plan for any plan year for which it is maintained by more than one employer and is maintained by a rural telephone cooperative association.

<sup>24</sup> The minimum funding requirements do not apply to most governmental or church plans.

<sup>25</sup> Sec. 4971.

<sup>26</sup> Pub. L. No. 109–280.

<sup>27</sup> Single-employer plans and multiple-employer plans have generally been subject to the same funding rules. Under section 413(c)(4), in the case of a multiple-employer plan established by December 31, 1988, the minimum funding requirement is generally determined as if all plan participants are employed by a single employer, and, in the case of a multiple-employer plan established after December 31, 1988, each employer is treated as maintaining a separate plan for purposes of the funding requirements unless the plan uses a method for determining required contributions that provides for any employer to contribute not less than the amount that would be required if the employer maintained a separate plan. ERISA section 210(a)(3) provides that the minimum funding requirement for a multiple-employer plan is determined as if all plan participants are employed by a single employer.

<sup>28</sup> Secs. 412 and 430 and ERISA secs. 302–303. For an explanation of the funding requirements for single-employer plans as amended by PPA, see Part I.D.2 of *Joint Committee on Taxation, Present Law and Background Relating to Qualified Defined Benefit Plans* (JCX–99–14), September 15, 2014, available at [www.jct.gov](http://www.jct.gov).

<sup>29</sup> PPA sec. 104.

<sup>30</sup> This is as defined in section 401(k)(7)(B) without regard to (iv) thereof and includes (1) organizations engaged primarily in providing electric service on a mutual or cooperative basis, or engaged primarily in providing electric service to the public in its service area and which is exempt from tax or which is a State or local government, other than a municipality; (2) certain civic leagues and business leagues exempt from tax 80 percent of the members of which are described in (1); (3) certain cooperative telephone companies; and (4) any organization that is a national association of organizations described above.

The PPA delayed effective date was extended to additional plans, “eligible charity plans,” by the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 (“PRA 2010”).<sup>31</sup> A plan in existence on July 26, 2005, is treated as an eligible charity plan for a plan year if (1) it is maintained by more than one employer (determined for this purpose without regard to the aggregation rules for groups under common control) and (2) 100 percent of the employers maintaining the plan are tax-exempt charitable organizations.<sup>32</sup>

***Funding rules applicable to eligible cooperative and eligible charity plans***<sup>33</sup>

*In general*

Under the funding requirements applicable to eligible cooperative and eligible charity plans (“eligible plans”) until the PPA delayed effective date, a notional account called a “funding standard account” is maintained, to which specific charges and credits (including plan contributions) are made for each plan year the plan is maintained. The minimum required contribution for a plan year is the amount, if any, needed so that the accumulated credits to the funding standard account as of that plan year are not less than the accumulated charges (that is, so the funding standard account does not have a negative balance). If, as of the close of a plan year, accumulated charges to the funding standard account exceed credits, the plan has an “accumulated funding deficiency” equal to the amount of the excess, which may result in an excise tax. For example, if, as of a plan year, the balance of charges to the funding standard account would be \$200,000 without any contributions, then a minimum contribution equal to that amount is required to meet the minimum funding standard for the year (that is, to prevent an accumulated funding deficiency). If credits to the funding standard account exceed charges, a “credit balance” results. The amount of the credit balance, increased with interest, has the effect of reducing future required contributions.

*Charges and credits to the funding standard account*

An acceptable actuarial cost method (referred to as a funding method) must be used to determine the elements included in a plan’s funding standard account for a year. Generally, a funding method breaks up the cost of benefits under the plan into annual charges to the funding standard account consisting of two elements for each plan year. These elements are referred to as (1) normal cost and (2) supplemental cost. IRS approval is required in order to change a plan’s funding method.

The plan’s normal cost for a plan year generally represents the cost of future benefits allocated to the year by the funding method used by the plan for current employees and, under some funding methods, for separated employees. Specifically, it is the amount ac-

<sup>31</sup> Pub. L. No. 111–192.

<sup>32</sup> Because separate employer status is determined without regard to the aggregation rules, some eligible charity plans are not multiple-employer plans. An organization is a tax-exempt charitable organization if it is exempt from income tax under section 501(c)(3).

<sup>33</sup> These rules are found in section 412 and ERISA sections 302–307 as in effect for plan years beginning before 2008.

tuarily determined that would be required as a contribution by the employer for the plan year in order to maintain the plan if the plan had been in effect from the beginning of service of the included employees and if the costs for prior years had been paid, and all assumptions (such as interest and mortality) had been fulfilled. A plan's normal cost for a plan year is charged to the funding standard account for that year.

The supplemental cost for a plan year is the cost of future benefits that would not be met by future normal costs, future employee contributions, or plan assets. The most common supplemental cost is that attributable to past service liability, which represents the cost of future benefits under the plan (1) on the date the plan is first effective or (2) on the date a plan amendment increasing plan benefits is first effective. Supplemental cost attributable to past service liability is generally amortized (that is, recognized for funding purposes) over 30 years by annual charges to the funding standard account over that period. Other supplemental costs that may apply (and the applicable amortization periods) include the following: net experience losses, such as worse than expected investment returns or actuarial experience (five years); losses from changes in actuarial assumptions (10 years); and amounts necessary to make up minimum required contributions for which a funding waiver was obtained (five years).

A plan sponsor may obtain from the IRS an extension of up to 10 years of the amortization periods applicable in determining charges to the funding standard account. The extension may be granted if the IRS determines that (1) the extension would carry out the purposes of ERISA and would provide adequate protection for participants and beneficiaries under the plan, and (2) the failure to permit the extension would (a) result in a substantial risk to the voluntary continuation of the plan or a substantial curtailment of pension benefit levels or employee compensation and (b) be adverse to the interests of plan participants in the aggregate.

Factors that result in a supplemental loss can alternatively result in a gain that is recognized by annual credits to the funding standard account over a specified amortization period, in addition to a credit for contributions made for the plan year. These include a reduction in unfunded past service liability as a result of a plan amendment decreasing plan benefits (30 years); net experience gains, such as better than expected investment returns or actuarial experience (five years); and gains from changes in actuarial assumptions (10 years). If minimum required contributions are waived, the waived amount (referred to as a "waived funding deficiency") is also credited to the funding standard account.

#### *Actuarial valuations*

Normal cost and supplemental costs under a plan are computed on the basis of an actuarial valuation of the assets and liabilities of a plan. An actuarial valuation is generally required annually and is made as of a date within the plan year or within one month before the beginning of the plan year. However, a valuation date within the preceding plan year may be used if, as of that date, the value of the plan's assets is at least 100 percent of the plan's cur-

rent liability (that is, the present value of benefits under the plan, as described below).

For funding purposes, the actuarial value of plan assets may be used, rather than fair market value. The actuarial value of plan assets is the value determined on the basis of a reasonable actuarial valuation method that takes into account fair market value and is permitted under Treasury regulations. Any actuarial valuation method used must result in a value of plan assets that is not less than 80 percent of the fair market value of the assets and not more than 120 percent of the fair market value. In addition, if the valuation method uses average value of the plan assets, values may be used for a stated period not to exceed the five most recent plan years, including the current year.

In applying the funding rules, all costs, liabilities, interest rates, and other factors are required to be determined on the basis of actuarial assumptions and methods, each of which is reasonable (taking into account the experience of the plan and reasonable expectations), or which, in the aggregate, result in a total plan contribution equivalent to a contribution that would be determined if each assumption and method were reasonable. In addition, the assumptions are required to offer the actuary's best estimate of anticipated experience under the plan.

#### *Deficit reduction contribution requirements*

Under the deficit reduction contribution rules, an additional charge to a plan's funding standard account is generally required for a plan year if the plan's funded current liability percentage for the plan year is less than 90 percent.<sup>34</sup> A plan's funded current liability percentage is generally the actuarial value of plan assets as a percentage of the plan's current liability. In general, a plan's current liability means the value of all liabilities to employees and their beneficiaries under the plan. In determining current liability, the interest rate and mortality table used are the "third segment rate" and the mortality table used in valuing liabilities under the PPA funding rules.<sup>35</sup>

The amount of the additional charge required under the deficit reduction contribution rules is the sum of two amounts: (1) the excess, if any, of (a) the deficit reduction contribution (as described below), over (b) the contribution required under the normal funding rules, and (2) the amount (if any) required with respect to unpredictable contingent event benefits. The amount of the additional charge cannot exceed the amount needed to increase the plan's funded current liability percentage to 100 percent, taking into account the expected increase in current liability due to benefits accruing during the plan year.

The deficit reduction contribution is generally the sum of (1) the applicable percentage of the plan's unfunded current liability, and

<sup>34</sup> An exception to the deficit reduction contribution requirements applies if the plan's funded current liability percentage for the plan year is at least 80 percent and, for at least two consecutive plan years in the preceding three plan years, the plan's funded current liability percentage was at least 90 percent. In addition, the deficit reduction contribution requirements generally do not apply to plans with 100 or fewer participants, and a pro-rata portion of the deficit reduction contribution applies to plans with more than 100 but not more than 150 participants.

<sup>35</sup> The PPA delayed effective date provides for the use of this interest rate. Under the rules in effect before PPA, the interest rate used in determining current liability was based on a four-year weighted average of interest rates on 30-year Treasury securities.



(2) the expected increase in current liability due to benefits accruing during the plan year.<sup>36</sup> For this purpose, the plan's unfunded current liability is the amount by which (1) the plan's current liability exceeds (2) the actuarial value of plan assets reduced by any credit balance. The applicable percentage is generally 30 percent, but decreases by 0.4 of one percentage point for each percentage point by which the plan's funded current liability percentage exceeds 60 percent. For example, if a plan's funded current liability percentage is 85 percent (that is, it exceeds 60 percent by 25 percentage points), the applicable percentage is 20 percent (30 percent minus 10 percentage points (25 multiplied by 0.4)).

A plan may provide for unpredictable contingent event benefits, which are benefits that depend on contingencies that are not reliably and reasonably predictable, such as facility shutdowns or reductions in workforce. The value of any unpredictable contingent event benefit is not considered in determining additional contributions until the event has occurred. The event on which an unpredictable contingent event benefit is contingent is generally not considered to have occurred until all events on which the benefit is contingent have occurred. If an event on which unpredictable contingent event benefits are contingent has occurred, the additional charge to the funding standard account is increased to take the unpredictable contingent event benefits into account.

#### *Other rules*

No contributions are required under these funding rules in excess of the full funding limitation. The full funding limitation is the excess, if any, of (1) the accrued liability under the plan (including normal cost), over (2) the lesser of (a) the market value of plan assets or (b) the actuarial value of plan assets. However, the full funding limitation may not be less than the excess, if any, of 90 percent of the plan's current liability (including the expected increase in current liability due to benefits accruing during the plan year) over the actuarial value of plan assets.<sup>37</sup>

In general, plan contributions required to satisfy the funding rules must be made within 8½ months after the end of the plan year. If the contribution is made by the due date, the contribution is treated as if it were made on the last day of the plan year. In the case of a plan with a funded current liability percentage of less than 100 percent for the preceding plan year, estimated contributions for the current plan year must be made in quarterly installments during the current plan year. The amount of each required installment is generally 25 percent of the lesser of (1) 90 percent of the amount required to be contributed for the current plan year or (2) 100 percent of the amount required to be contributed for the preceding plan year. If a required installment is not made, interest applies for the period of underpayment at a rate of the greater of (1) 175 percent of the Federal mid-term rate, or (2) the interest rate used for funding purposes under the plan. If quarterly con-

<sup>36</sup> If the use of a new required mortality table results in an increase in a plan's current liability, the deficit reduction contribution also includes the amount needed to amortize the increase over 10 years (referred to as the "unfunded mortality increase amount").

<sup>37</sup> In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability under the full funding limitation may be based on projected future benefits, including future salary increases.

tributions are required with respect to a plan, the amount of a quarterly installment must also be sufficient to cover any shortfall in the plan's liquid assets (a "liquidity shortfall"). In general, a plan has a liquidity shortfall for a quarter if the plan's liquid assets (such as cash and marketable securities) are less than a certain amount (generally determined by reference to disbursements from the plan in the preceding 12 months).

The IRS is permitted to waive all or a portion of the contribution required under the minimum funding standard for a plan year (a "waived funding deficiency"). A waiver may be granted if the employers responsible for the contribution could not make the required contribution without temporary substantial business hardship and if requiring the contribution would be adverse to the interests of plan participants in the aggregate. Generally, no more than three waivers may be granted within any period of 15 consecutive plan years. The IRS is authorized to require security to be provided as a condition of granting a funding waiver if the sum of the plan's accumulated funding deficiency and the balance of any outstanding waived funding deficiencies exceeds \$1 million.

### ***Funding-related benefit restrictions***

Under PPA, single-employer and multiple-employer defined benefit plans are generally subject to funding-related benefit restrictions.<sup>38</sup> The PPA delayed effective date for eligible plans applies also to the funding related benefit restrictions.

Certain funding-related benefit restrictions that predate PPA continue to apply to eligible plans until the PPA delayed effective date.

As described above, if quarterly contributions are required with respect to a plan and the plan has a liquidity shortfall, the amount of a quarterly installment must also be sufficient to cover the liquidity shortfall. If a quarterly installment is less than the amount required to cover the plan's liquidity shortfall, limits apply to the benefits that can be paid from a plan during the period of underpayment. During that period, the plan may not make any prohibited payment, defined as (1) any payment in excess of the monthly amount paid under a single life annuity (plus any social security supplement provided under the plan) to a participant or beneficiary whose annuity starting date occurs during the period, (2) any payment for the purchase of an irrevocable commitment from an insurer to pay benefits (for example, an annuity contract), or (3) any other payment specified by the Secretary of the Treasury by regulations.<sup>39</sup>

Subject to certain exceptions, if an employer maintaining a plan is involved in bankruptcy proceedings, no plan amendment may be adopted that increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits, or any change in the rate at which benefits vest under the plan.<sup>40</sup> This limitation does not apply if the plan's funded current liability per-

<sup>38</sup> Section 430 and ERISA section 206(g).

<sup>39</sup> Sec. 401(a)(32) and ERISA sec. 206(e).

<sup>40</sup> Sec. 401(a)(33) and ERISA sec. 204(i).

centage is at least 100 percent, taking into account the amendment.

### ***Explanation of Provision***

#### ***In general***

As discussed below, the provision generally provides new, permanent minimum funding rules under the Code and ERISA for certain plans eligible for the PPA delayed effective date, referred to as “CSEC” plans. A CSEC plan is a defined benefit plan (other than a multiemployer plan) (1) that is an eligible cooperative plan to which the PPA delayed effective date applies (without regard to the January 1, 2017, end date), or (2) that, as of June 25, 2010 (the date of enactment of PRA 2010), was maintained by more than one employer (taking into account the aggregation rules for controlled groups and groups under common control) and all of the employers were tax-exempt charitable organizations.<sup>41</sup>

If a plan is treated as a CSEC plan, the delayed effective date for the PPA funding rules ceases to apply to the plan as of the first date the plan is treated as a CSEC plan.<sup>42</sup> However, a plan described in (1) or (2) is not a CSEC plan if the plan sponsor elects, not later than the close of the first plan year beginning after December 31, 2013, not to be treated as a CSEC plan.<sup>43</sup> An election takes effect for the first plan year beginning after December 31, 2013, and, once made, may be revoked only with the consent of the Secretary of the Treasury.

#### ***Funding rules for CSEC plans***

##### ***In general***

Under the provision, CSEC plans are permanently exempted from the PPA funding rules generally applicable to single-employer plans and multiple-employer plans. The provision establishes new minimum funding rules for CSEC plans that are similar to the rules applicable to eligible cooperative and eligible charity plans under the PPA delayed effective date, with the following modifications:<sup>44</sup>

- the deficit reduction contribution rules are repealed with respect to CSEC plans,
- new rules apply, as discussed below, to a CSEC plan in “restoration status,”
- supplemental cost attributable to past service liability and a reduction in unfunded past service liability as a result of a plan amendment decreasing plan benefits are amortized over 15 years (rather than 30 years),

<sup>41</sup> See Part Nine, IV.C for an amendment to this definition.

<sup>42</sup> A plan maintained by employers treated as a single employer under the aggregation rules is not a CSEC plan as defined under the provision. Thus, not all eligible charity plans as defined for purposes of the PPA delayed effective date come within the definition of CSEC plan. Those that do not may continue to be covered by the PPA delayed effective date.

<sup>43</sup> If an election not to be treated as a CSEC plan is made with respect to a plan eligible for the PPA delayed effective date, the plan may continue to be covered by the delayed effective date unless making an election as described in Part B.

<sup>44</sup> Under the provision, a CSEC plan’s amortization bases for plan years beginning before January 1, 2014, and related charges and credits continue to apply. In addition, the minimum funding requirement for a CSEC plan is determined as if all plan participants are employed by a single employer.

- any funding method available to a CSEC plans under the funding rules in effect before PPA continues to be available under the CSEC rules,<sup>45</sup>
- all costs, liabilities, interest rates, and other factors are required to be determined on the basis of actuarial assumptions and methods, each of which is reasonable (taking into account the experience of the plan and reasonable expectations),<sup>46</sup> and
- the IRS may grant an amortization period extension to a CSEC plan if it determines that (1) the extension would carry out the purposes of ERISA and would provide adequate protection for participants and beneficiaries under the plan, and (2) the failure to permit the extension would result in a substantial risk to the voluntary continuation of the plan or a substantial curtailment of pension benefit levels or employee compensation.

*Rules relating to restoration status*

If a CSEC plan is in funding restoration status for a plan year, as discussed below, a special minimum contribution requirement applies, the plan sponsor must adopt a funding restoration plan, and the plan generally may not be amended to increase benefits. Under the provision, not later than the 90th day of a CSEC plan's plan year, the plan actuary of a CSEC plan must certify to the plan sponsor whether or not the plan is in funding restoration status for the plan year, based on the plan's funded percentage as of the beginning of the plan year.

A CSEC plan is in funding restoration status for a plan year if the plan's funded percentage as of the beginning of the plan year is less than 80 percent. For this purpose, funded percentage means the ratio (expressed as a percentage) that the value of the plan's assets bears to the plan's funding liability. A plan's funding liability for a plan year is the present value of all benefits accrued or earned under the plan as of the beginning of the plan year, determined using the assumptions, including interest and mortality, used in other funding computations with respect to plan. In making the certification described above, the plan actuary may conclusively rely on an estimate of (1) the plan's funding liability, based on the funding liability of the plan for the preceding plan year and on reasonable actuarial estimates, assumptions, and methods, and (2) the amount of any contributions reasonably anticipated to be made for the preceding plan year.<sup>47</sup> Reasonably anticipated contributions for the preceding year are taken into account in determining the plan's funded percentage as of the beginning of the plan year.

If a plan is in restoration status for a plan year, the minimum required contribution is the greater of (1) the amount otherwise required without regard to restoration status and (2) the normal cost

<sup>45</sup> As under present law, IRS approval is required for a change in funding method.

<sup>46</sup> As under present law, the assumptions are also required to offer the actuary's best estimate of anticipated experience under the plan.

<sup>47</sup> Because contributions for a plan year may be made up to 8½ months after the end of the plan year, some contributions for the preceding year might not have been made by the time of the certification.

of the plan for the plan year.<sup>48</sup> Thus, an accumulated funding deficiency will result if contributions are less than normal cost.

If a CSEC plan is certified as being in restoration status, within 180 days after receipt of the certification, the plan sponsor must establish a written funding restoration plan. If a CSEC plan remains in funding restoration status for more than a year, the plan sponsor must update the funding restoration plan each year within 180 days after receipt of the certification of restoration status. If a plan sponsor fails to adopt or update a funding restoration plan as required, the plan sponsor may be subject to an excise tax under the Code or an ERISA penalty of up to \$100 per day.

A funding restoration plan must consist of actions that are calculated, based on reasonably anticipated experience and reasonable actuarial assumptions, to increase the plan's funded percentage to 100 percent over seven years, or, if sooner, the shortest amount of time practicable. The funding restoration plan is to take into account contributions required under the minimum funding requirements (determined without regard to the funding restoration plan).

If a CSEC plan is in funding restoration status for a plan year, no plan amendment may take effect during the plan year if it has the effect of increasing plan liabilities by means of increases in benefits, establishment of new benefits, changing the rate of benefit accrual, or changing the rate at which benefits vest under the plan. However, this prohibition does not apply to any plan amendment required to comply with any applicable law. The prohibition ceases to apply with respect to any plan year, effective as of the first day of the plan year (or if later, the effective date of the amendment), if a plan contribution is made, in addition to any contribution otherwise required under the funding rules, in an amount equal to the increase in the plan's funding liability as a result of the plan amendment.

### ***Funding-related benefit restrictions***

Under the provision, CSEC plans are permanently exempted from the PPA funding-related benefit restrictions. CSEC plans are also exempted from (1) the restrictions on benefit increases when an employer maintaining a plan is involved in bankruptcy proceedings and (2) the ERISA restriction on prohibited payments if a plan has a liquidity shortfall and a quarterly installment is less than the amount required to cover the liquidity shortfall.

### ***Effective Date***

The provision is generally effective for plan years beginning after December 31, 2013. The provision allowing a plan sponsor to elect out of CSEC status is effective on the date of enactment (April 7, 2014).

---

<sup>48</sup>In certain cases, a specific funding method, the entry age normal funding method, must be used in determining normal cost for this purpose.

**B. Election to Cease Treatment as an Eligible Charity Plan  
(sec. 103(b) and (d) of the Act, sec. 430 of the Code and sec.  
303 of ERISA)**

***Present Law***

***PPA funding rules for single-employer and multiple-employer plans***

*In general*

Under PPA, new Code and ERISA minimum funding requirements apply to single-employer and multiple-employer defined benefit plans, generally effective for plan years beginning after December 31, 2007.<sup>49</sup>

Under these rules, the minimum required contribution with respect to a plan for a plan year generally depends on a comparison of the value of the plan's assets, reduced by any prefunding balance or funding standard carryover balance ("net value of plan assets"),<sup>50</sup> with the plan's funding target (the present value of all benefits accrued or earned as of the beginning of the plan year) and the plan's target normal cost (the present value of benefits expected to accrue or to be earned during the plan year plus administrative expenses).<sup>51</sup>

If the net value of plan assets is less than the plan's funding target, so that the plan has a funding shortfall (discussed further below), the minimum required contribution is the sum of the plan's target normal cost and the shortfall amortization charge for the plan year (determined as described below).<sup>52</sup> If the net value of plan assets is equal to or exceeds the plan's funding target, the minimum required contribution is the plan's target normal cost, reduced by the amount, if any, by which the net value of plan assets exceeds the plan's funding target.

*Shortfall amortization charge*

The shortfall amortization charge for a plan year is the sum of the annual shortfall amortization installments attributable to the shortfall bases for that plan year and the six previous plan years. Generally, if a plan has a funding shortfall for the plan year, a shortfall amortization base must be established for the plan year.<sup>53</sup>

<sup>49</sup> Secs. 412 and 430 and ERISA secs. 302–303. For further explanation of the funding requirements for single-employer plans as amended by PPA, see Part I.D.2 of *Joint Committee on Taxation, Present Law and Background Relating to Qualified Defined Benefit Plans* (JCX–99–14), September 15, 2014, available at [www.jct.gov](http://www.jct.gov).

<sup>50</sup> The value of plan assets is generally reduced by any prefunding balance or funding standard carryover balance in determining minimum required contributions. A prefunding balance results from contributions to a plan that exceed the minimum required contributions. A funding standard carryover balance results from a positive balance in the funding standard account that applied under the funding requirements in effect before PPA. Subject to certain conditions, a prefunding balance or funding standard carryover balance may be credited against the minimum required contribution for a year, reducing the amount that must be contributed.

<sup>51</sup> Specific interest and mortality assumptions generally apply in determining a plan's funding target and target normal cost.

<sup>52</sup> If the plan has obtained a funding waiver within the past five years, the minimum required contribution also includes the related waiver amortization charge, that is, the annual installment needed to amortize the waived amount in level installments over the five years following the year of the waiver.

<sup>53</sup> If the value of plan assets, reduced only by any prefunding balance if the employer elects to apply the prefunding balance against the required contribution for the plan year, is at least equal to the plan's funding target, no shortfall amortization base is established for the year.

A plan's funding shortfall is the amount by which the plan's funding target exceeds the net value of plan assets. The shortfall amortization base for a plan year is (1) the plan's funding shortfall, minus (2) the present value of the aggregate total of the "shortfall amortization installments" that have been determined for the plan year and any succeeding plan year with respect to any shortfall amortization bases for the six previous plan years. The shortfall amortization base is amortized in level annual installments (the "shortfall amortization installments") over a seven-year period beginning with the current plan year and using specified interest assumptions.<sup>54</sup>

If the net value of plan assets for a plan year is at least equal to the plan's funding target for the year, so the plan has no funding shortfall, any shortfall amortization bases and related shortfall amortization installments are eliminated.<sup>55</sup> As indicated above, if the net value of plan assets exceeds the plan's funding target, the excess is applied against target normal cost in determining the minimum required contribution.

#### *PRA 2010 relief under the PPA rules*

The Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 ("PRA 2010") allowed the sponsor of a plan subject to the PPA funding rules to elect a 15-year amortization period, rather than a seven-year amortization period, with respect to the shortfall amortization bases for two plan years ("election years") of the four plan years beginning in 2008, 2009, 2010 and 2011.<sup>56</sup> The use of the longer amortization period for an eligible plan year had the effect of reducing the shortfall amortization installments attributable to the shortfall amortization base for that plan year, thus reducing required contributions for the first seven years in the 15-year amortization period.

Under PRA 2010, if, in any of the five years following an election year, the plan sponsor provides excessive compensation to an employee (generally, compensation in excess of \$1 million) or provides an extraordinary dividend or redemption with respect to its stock, subject to certain limits, the remaining shortfall amortization installments attributable to the shortfall amortization base for the election year are generally accelerated, increasing the required contribution for that year.

#### *PPA delayed effective date for eligible charity plans*

As discussed in Part A, under PRA 2010, a delayed effective date for the PPA funding rules applies to "eligible charity plans." A plan in existence on July 26, 2005, is treated as an eligible charity plan

<sup>54</sup> The shortfall amortization base for a plan year may be positive or negative, depending on whether the present value of remaining installments with respect to amortization bases for previous years is more or less than the plan's funding shortfall. If the shortfall amortization base is positive (that is, the funding shortfall exceeds the present value of the remaining installments), the related shortfall amortization installments are positive. If the shortfall amortization base is negative, the related shortfall amortization installments are negative. The positive and negative shortfall amortization installments for a particular plan year are netted when adding them up in determining the shortfall amortization charge for the plan year, but the resulting shortfall amortization charge cannot be less than zero (that is, negative amortization installments may not offset normal cost).

<sup>55</sup> Any amortization base relating to a funding waiver for a previous year is also eliminated.

<sup>56</sup> PRA 2010 also provided funding relief that could be elected with respect to a plan eligible for the delayed PPA effective date discussed below.

for a plan year if (1) it is maintained by more than one employer (determined for this purpose without regard to the aggregation rules for groups under common control) and (2) 100 percent of the employers maintaining the plan are tax-exempt charitable organizations. Under the delayed effective date, the PPA funding rules apply to an eligible charity plan as of the earlier of (1) the first plan year for which the plan ceases to be an eligible charity plan or (2) January 1, 2017.<sup>57</sup>

### ***Explanation of Provision***

#### ***In general***

The provision allows the plan sponsor of an eligible charity plan (as defined under PRA 2010) to elect that the plan cease being treated as an eligible charity plan for plan years beginning after December 31, 2013. In the case of an eligible charity plan that is not a CSEC plan as discussed in Part A, the election has the effect of applying the PPA funding rules for these years.<sup>58</sup> A plan sponsor that makes an election may also elect to use a special computation, as discussed below, in applying the PPA funding rules to the first plan year beginning after December 31, 2013. Either of these elections must be made at the time and in the form and manner as prescribed by the Secretary of the Treasury and may be revoked only with the consent of the Secretary.

The provision also allows the plan sponsor of an eligible charity plan (as defined under PRA 2010) to make a one-time, irrevocable election not to be treated as an eligible charity plan, retroactive to the first plan year beginning after December 31, 2007.<sup>59</sup> This election is made by providing reasonable notice to the Secretary.

#### ***Special funding computation***

Under the special computation, for the first plan year beginning after December 31, 2013, rather than a single shortfall amortization base, a plan has (1) an 11-year shortfall amortization base, (2) a 12-year shortfall amortization base, and (3) a 7-year shortfall amortization base.<sup>60</sup> The shortfall amortization charges for the first plan year beginning after December 31, 2013, and subsequent years include the shortfall amortization installments attributable to the three shortfall amortization bases. The shortfall amortization installments attributable to the 11-year shortfall amortization base and the 12-year shortfall amortization base are determined as under the PPA rules, except that 11-year and 12-year periods, re-

<sup>57</sup> Because the PPA funding rules had already gone into effect for plan years beginning after December 31, 2007, retroactive application of the delayed effective date under PRA 2010 meant that some eligible charity plans already using the PPA rules could be forced to change back to the pre-PPA rules, resulting in administrative burden and expense.

<sup>58</sup> In the case of an eligible charity plan that is a CSEC plan, this result can be obtained by also making an election out of CSEC treatment as described in Part A.

<sup>59</sup> This election would affirm an eligible charity plan's consistent use of the PPA funding rules plan year beginning after December 31, 2007, rather than applying the PPA delayed effective date as extended to eligible charity plans by PRA 2010.

<sup>60</sup> Eleven years is the period that would remain as of 2014 if, under PRA 2010, a 15-year amortization period had been used with respect to a plan's shortfall amortization base for 2010, and twelve years is the period that would remain as of 2014 if, under PRA 2010, a 15-year amortization period had been used with respect to a plan's shortfall amortization base for 2011.



spectively, are substituted for the seven-year amortization period applicable under PPA.

The plan's 11-year shortfall amortization base is the amount that, as of the first plan year beginning after December 31, 2013, would be the unamortized principal amount of the shortfall amortization base that would have applied to the plan for the first plan year beginning after December 31, 2009, if the plan had never been an eligible charity plan,<sup>61</sup> the plan sponsor had elected a 15-year amortization period for that year, and no event (such as excessive employee compensation) had occurred to accelerate the shortfall amortization installments attributable to the shortfall amortization base for that year. Similarly, the plan's 12-year shortfall amortization base is the amount that, as of the first plan year beginning after December 31, 2013, would be the unamortized principal amount of the shortfall amortization base that would have applied to the plan for the first plan year beginning after December 31, 2010, if the plan had never been an eligible charity plan, the plan sponsor had elected a 15-year amortization period for that year, and no event (such as excessive compensation) had occurred to accelerate the shortfall amortization installments attributable to the shortfall amortization base for that year. The plan's 7-year shortfall amortization base is the amount of the shortfall amortization base for the first plan year beginning after December 31, 2013, determined without regard to the special computation, minus the sum of the plan's 11-year and 12-year shortfall amortization bases.

Under the provision, the PRA 2010 rules relating to the acceleration of shortfall amortization installments attributable to the shortfall amortization base for the first plan year beginning after December 31, 2013, are applied by treating that year (and no other year) as an election year.

### ***Effective Date***

The provision is effective on the date of enactment (April 7, 2014).

### **C. Deemed Election for Church Plans (sec. 103(c) and (d) of the Act and sec. 410(d) of the Code)**

#### ***Present Law***

#### ***PBGC insurance program***

The Pension Benefit Guaranty Corporation ("PBGC") provides an insurance program for benefits under most defined benefit plans maintained by private employers.<sup>62</sup> Defined benefit plans covered by the PBGC insurance program are required to pay annual premiums to the PBGC.

If the assets of a single-employer plan are not sufficient to pay benefits due under the plan and the plan terminates in a distress

<sup>61</sup> If the plan had never been an eligible charity plan, shortfall amortization bases under the PPA funding rules would have applied for the previous two plan years beginning after December 31, 2007. Thus, the shortfall amortization base for the first plan beginning after December 31, 2009 would have been (1) the plan's funding shortfall for that year, minus (2) the present value of the aggregate total of the remaining shortfall amortization installments attributable to the shortfall amortization bases for the two previous plan years.

<sup>62</sup> ERISA secs. 4001–4402.

termination (for example, in a bankruptcy proceeding of the employer maintaining the plan), the plan becomes the responsibility of the PBGC. The PBGC becomes the trustee of the plan, takes control of any plan assets, and assumes responsibility for benefits that cannot be provided from plan assets, subject to certain limits.

### ***Church Plans***

A church plan is generally exempted from various Code requirements otherwise applicable to qualified retirement plans, including, in the case of a defined benefit plan that is a church plan, the minimum funding requirements.<sup>63</sup> A church plan is also generally exempt from ERISA, including, in the case of a defined benefit plan that is a church plan, the PBGC insurance program.<sup>64</sup>

A church plan is defined as a plan established and maintained for its employees by a church or by a convention or association of churches that is exempt from income tax.<sup>65</sup> For this purpose, an employee of a church or a convention or association of churches includes an employee of an organization, whether a civil law corporation or otherwise, that is exempt from income tax and is controlled by or associated with a church or a convention or association of churches.

The exemption from the Code requirements does not apply if the church or convention or association of churches maintaining the plan makes an election to apply the Code requirements (referred to as an “electing” church plan).<sup>66</sup> This election is irrevocable. If an election is made, the Code requirements apply to the electing church plan in the same manner as other plans. In addition, ERISA applies to an electing church plan. With respect to coverage under the PBGC insurance program, an electing church plan must notify the PBGC that it wishes to have the provisions of the PBGC insurance program apply.

### ***Explanation of Provision***

Under the provision, in certain circumstances, an irrevocable election of electing church plan status is deemed to have been made with respect to a church plan. An election is deemed to have been made if (1) the plan was established before January 1, 2014, (2) the plan meets the definition of a CSEC plan, (3) the plan sponsor does not elect out of CSEC treatment, and (4) the plan, plan sponsor, plan administrator, or fiduciary remits one or more premium payments for the plan to the PBGC for a plan year beginning after December 31, 2013.

If a deemed election is made, the plan covered by the election is an electing church plan and is subject to the Code requirements generally applicable to qualified retirement plans and to ERISA.

<sup>63</sup> Secs. 401(a), last sentence, 410(c)(1)(B) and (d), 411(e)(1)(B), and 412(e)(2)(D). A church plan is also exempted from the vesting and anti-cutback requirements generally applicable to qualified retirement plans.

<sup>64</sup> ERISA secs. 4(b)(2) and 4021(b)(3).

<sup>65</sup> Sec. 414(e). A similar definition applies under ERISA section 3(33).

<sup>66</sup> Sec. 410(d) and Treas. Reg. sec. 1.410(d)-1. A church plan with respect to which an election under section 410(d) is not made is referred to as a “nonelecting” church plan.

### ***Effective Date***

The provision is effective on the date of enactment (April 7, 2014).

### **D. Transparency in Annual Reports and Notices (secs. 3 and 104 of the Act and secs. 101(d), 101(f) and 103 of ERISA)**

#### ***Present Law***

Under ERISA, the plan administrator of a defined benefit or defined contribution plan must file an annual report with the Secretary of Labor. The annual report must contain certain information about the plan, such as a statement of the plan's assets and liabilities and contributions made for the plan year.<sup>67</sup>

ERISA requires the plan administrator of a defined benefit plan to provide an annual funding notice to each plan participant and beneficiary, each labor organization representing participants or beneficiaries, and the PBGC. Certain information must be included in any funding notice, regardless of the type of plan, that is, regardless of whether the plan is a single-employer, multiple-employer or multiemployer plan. Funding notices must also include additional information that varies with the type of plan.

ERISA requires an employer maintaining a single-employer or multiple-employer defined benefit plan to notify plan participants and beneficiaries if the employer fails to make contributions required under the funding rules. An exception applies if the employer requests a funding waiver from the IRS. However, if the waiver request is denied, the employer must notify the employees of the failure to make required contributions within 60 days after the denial.

#### ***Explanation of Provision***

In connection with the funding rules for CSEC plans as discussed in Part A, the provision revises the annual report and certain notice requirements as described below.

The provision requires the annual report filed with respect to a CSEC plan to include a list of participating employers and a good faith estimate of the percentage of total contributions made by the participating employers during the plan year.

The provision amends the annual funding notice requirements to require a funding notice with respect to a CSEC plan to include (1) a statement that different rules apply to CSEC plans than apply to single-employer plans, (2) for the first two plan years beginning after December 31, 2013, a statement that, as a result of changes made by the Cooperative and Small Employer Charity Pension Flexibility Act, the contributions to the plan may have changed, and (3) in the case of a CSEC plan in funding restoration status for a plan year, a statement that the plan is in funding restoration status for the plan year. A copy of the statement described in (3)

<sup>67</sup> Similar annual reporting requirements apply under the Code (sections 6058 and 6059), and, under section 4065 of ERISA, the plan administrator of a defined benefit plan must file an annual report with the PBGC. A plan administrator complies with all of these Code and ERISA reporting requirements by filing an Annual Return/Report of Employee Benefit Plan, Form 5500 series, and providing the information as required on the form and related instructions.

must be provided to the Secretary of Labor, the Secretary of the Treasury, and the Director of the PBGC.

Under the provision, if an employer maintaining a CSEC plan fails to make a required contribution, the employer must notify plan participants and beneficiaries unless the employer requests a funding waiver. However, if the waiver request is denied, the employer must notify the employees of the failure to make required contributions within 60 days after the denial.

***Effective Date***

The provision is effective for years beginning after December 31, 2013.

**E. Sponsor Education and Assistance (secs. 3 and 105 of the Act and sec. 4004 of ERISA)**

***Present Law***

Under ERISA, the PBGC board of directors selects a Participant and Plan Sponsor Advocate, who generally acts as a liaison between the PBGC, defined benefit plan sponsors, and participants in defined benefit plans trustee by the PBGC.

***Explanation of Provision***

Under the provision, the Participant and Plan Sponsor Advocate is directed as part of his or her duties to make himself or herself available to assist CSEC plan sponsors and participants.

***Effective Date***

The provision is effective for years beginning after December 31, 2013.

**PART SEVEN: REVENUE PROVISIONS OF THE HIGHWAY  
AND TRANSPORTATION FUNDING ACT OF 2014 (PUB-  
LIC LAW 113-159)<sup>68</sup>**

**A. Extension of Highway Trust Fund Expenditure Authority  
(sec. 2001 of the Act and secs. 9503, 9504 and 9508 of the  
Code)**

***Present Law***

***In general***

Six separate excise taxes are imposed to finance the Federal Highway Trust Fund program. Three of these taxes are imposed on highway motor fuels. The remaining three are a retail sales tax on heavy highway vehicles, a manufacturers' excise tax on heavy vehicle tires, and an annual use tax on heavy vehicles. A substantial majority of the revenues produced by the Highway Trust Fund excise taxes are derived from the taxes on motor fuels. The annual use tax on heavy vehicles expires October 1, 2017. Except for 4.3 cents per gallon of the Highway Trust Fund fuels tax rates, the remaining taxes are scheduled to expire October 1, 2016. The 4.3-cents-per-gallon portion of the fuels tax rates is permanent.<sup>69</sup>

Revenues from the excise taxes generally are dedicated to the Highway Trust Fund. Dedication of excise tax revenues to the Highway Trust Fund and expenditures from the Highway Trust Fund are governed by the Code.<sup>70</sup> As discussed below, the Code authorizes expenditures (subject to appropriations) from the Highway Trust Fund through September 30, 2014.

***Highway Trust Fund expenditure purposes***

Section 9503 contains the operative rules for the transfer of revenues to the Highway Trust Fund and for the expenditure of monies from the Highway Trust Fund. In general, these rules provide for transfer from the General Fund of "gross receipts" from the Highway Trust Fund excise taxes to the Highway Trust Fund. Amounts deposited in the Highway Trust Fund are divided between a Mass Transit Account and a residual account, the "Highway Account."<sup>71</sup> The Mass Transit Account generally receives 2.86 cents per gallon

<sup>68</sup>H.R. 5021. The House Committee on Ways and Means reported H.R. 5021 on July 14, 2014 (H.R. Rep. 113-520 (Part 1)). The House passed H.R. 5021 on July 15, 2014. The Senate passed the bill with an amendment on July 29, 2014. The House disagreed to the Senate amendment on July 31, 2014, and the Senate receded from its amendment the same day. The President signed the bill on August 8, 2014.

<sup>69</sup>This portion of the tax rates was enacted as a deficit reduction measure in 1993. Receipts from it were retained in the General Fund until 1997 legislation provided for their transfer to the Highway Trust Fund.

<sup>70</sup>Sec. 9503. Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended (the "Code").

<sup>71</sup>Sec. 9503(e)(1).

of the Highway Trust Fund motor fuels excise taxes.<sup>72</sup> The balance of the motor fuels tax receipts and all receipts from the three non-fuels excise taxes are deposited in the Highway Account.

The Highway Trust Fund expenditure purposes have been revised with each authorization Act enacted since establishment of the Highway Trust Fund in 1956. In general, expenditures authorized under those Acts (as the Acts were in effect on the date of enactment of the most recent such authorizing Act, currently the Moving Ahead for Progress in the 21st Century Act or “MAP-21”<sup>73</sup>) are specified by the Code as authorized Highway Trust Fund expenditure purposes.<sup>74</sup> The Code provides that the authority to make expenditures from the Highway Trust Fund for these purposes expires after September 30, 2014. Thus, no Highway Trust Fund expenditures may occur after September 30, 2014, without an amendment to the Code.

### ***Reasons for Change***

The current Highway Trust Fund expenditure authority was expiring after September 30, 2014. The Congress believed that an extension of that authority, through May 31, 2015, would give the Congress sufficient time to carefully consider a more long-term reauthorization of the Highway Trust Fund and also minimize disruption and provide some stability for State transportation programs dependent on funding from the Highway Trust Fund.

### ***Explanation of Provision***

The expenditure authority for the Highway Trust Fund is extended through May 31, 2015. The Code provisions governing the purposes for which monies in the Highway Trust Fund may be spent are updated to include the “Highway and Transportation Funding Act of 2014.” The provision also updates the Code provisions governing the Leaking Underground Storage Tank Trust Fund, and the Sport Fish Restoration and Boating Trust Fund.

### ***Effective Date***

The provision is effective on the date of enactment (August 8, 2014).

## **B. Funding of the Highway Trust Fund (sec. 2002 of the Act and secs. 9503(f) and 9508(c) of the Code)**

### ***Present Law***

Public Law No. 110–318, “an Act to amend the Internal Revenue Code of 1986 to restore the Highway Trust Fund balance” transferred, out of money in the Treasury not otherwise appropriated, \$8,017,000,000 to the Highway Trust Fund effective September 15, 2008. Public Law No. 111–46, “an Act to restore sums to the Highway Trust Fund,” transferred, out of money in the Treasury not otherwise appropriated, \$7 billion to the Highway Trust Fund ef-

<sup>72</sup> Sec. 9503(e)(2).

<sup>73</sup> The short title for Pub. L. No. 112–141 is “MAP-21” and the law is also known as the “Moving Ahead for Progress in the 21st Century Act.”

<sup>74</sup> Sec. 9503(c)(1).

fective August 7, 2009. The Hiring Incentives to Restore Employment Act transferred, out of money in the Treasury not otherwise appropriated, \$14,700,000,000 to the Highway Trust Fund and \$4,800,000,000 to the Mass Transit Account in the Highway Trust Fund.<sup>75</sup>

MAP-21 provided that, out of money in the Treasury not otherwise appropriated, the following transfers were to be made from the General Fund to the Highway Trust Fund:

	FY 2013	FY 2014
Highway Account .....	\$6.2 billion .....	\$10.4 billion
Mass Transit Account .....	.....	\$2.2 billion

MAP-21 also transferred \$2.4 billion from the Leaking Underground Storage Tank Trust Fund to the Highway Account in the Highway Trust Fund.<sup>76</sup>

### ***Reasons for Change***

Both the Highway Account and the Mass Transit Account of the Highway Trust Fund were nearing insolvency. If the Congress did not act, it was anticipated that the Mass Transit Account would have only \$1 billion available by the end of the fiscal year, and the Highway Account was expected to experience a shortfall by August 2014.<sup>77</sup> As a result, the Department of Transportation had notified State transportation authorities that beginning August 1, 2014, for programs funded out of the Highway Account, the Department of Transportation would undertake cash management procedures that would limit payments and eliminate “same-day” reimbursements to States.<sup>78</sup> Instead, payments would be made twice a month and incoming funds would be distributed in proportion to each State’s Federal formula apportionment in the 2014 fiscal year.

The Congress believed that additional funding for the Highway Trust Fund should be provided in an amount sufficient to avoid short-term disruption of Federally-funded transportation programs, while giving the Congress enough time to stabilize that Trust Fund’s finances over the longer term. The Congress further believed that this additional, short-term funding should be provided to the Highway Trust Fund in a manner that was budget-neutral and did not involve permanent tax increases.

### ***Explanation of Provision***

The provision transfers from the General Fund \$7.765 billion to the Highway Account of the Highway Trust Fund and \$2 billion to the Mass Transit Account of the Highway Trust Fund. The provision also transfers \$1 billion from the Leaking Underground Storage Tank Trust Fund to the Highway Account of the Highway Trust Fund.

<sup>75</sup>The Hiring Incentives to Restore Employment Act (the “HIRE” Act), Pub. L. No. 111–147, sec. 442.

<sup>76</sup>Moving Ahead for Progress in the 21st Century Act (“MAP-21”), Pub. L. No. 112–141, sec. 40201(a)(2) and sec. 40251.

<sup>77</sup>U.S. Department of Transportation, *Highway Trust Fund Ticker* (July 9, 2014). <<http://www.dot.gov/highway-trust-fund-ticker>>

<sup>78</sup>See, e.g., Anthony R. Foxx, *Letter of Anthony R. Foxx, Secretary of Transportation, to John R. Cooper, Transportation Director, Alabama Department of Transportation* (July 1, 2014).

### ***Effective Date***

The provision is effective on the date of enactment (August 8, 2014).

## **C. Pension Funding Stabilization (sec. 2003 of the Act and secs. 430 and 436 of the Code)**

### ***Present Law***

#### ***Minimum funding rules***

A defined benefit plan maintained by a single employer is subject to minimum funding rules that generally require the sponsoring employer to make a certain level of contribution for each plan year to fund plan benefits.<sup>79</sup> The minimum funding rules for single-employer defined benefit plans were substantially revised by the Pension Protection Act of 2006 (“PPA”).<sup>80</sup>

#### ***Minimum required contributions***

##### ***In general***

The minimum required contribution for a plan year for a single-employer defined benefit plan generally depends on a comparison of the value of the plan’s assets, reduced by any prefunding balance or funding standard carryover balance (“net value of plan assets”),<sup>81</sup> with the plan’s funding target and target normal cost. The plan’s funding target for a plan year is the present value of all benefits accrued or earned as of the beginning of the plan year. A plan’s target normal cost for a plan year is generally the present value of benefits expected to accrue or to be earned during the plan year.

If the net value of plan assets is less than the plan’s funding target, so that the plan has a funding shortfall (discussed further below), the minimum required contribution is the sum of the plan’s target normal cost and the shortfall amortization charge for the plan year (determined as described below).<sup>82</sup> If the net value of plan assets is equal to or exceeds the plan’s funding target, the

<sup>79</sup>Sec. 412 and section 302 of the Employee Retirement Income Security Act of 1974 (“ERISA”). For purposes of whether a plan is maintained by a single employer, certain related entities, such as the members of a controlled group, are treated as a single employer. Different funding rules apply to multiemployer and multiple-employer defined benefit plans, which are types of plans maintained by two or more unrelated employers. A number of exceptions to the minimum funding rules apply. For example, governmental plans (within the meaning of section 414(d)) and church plans (within the meaning of section 414(e)) are generally not subject to the minimum funding rules. Under section 4971, an excise tax applies if the minimum funding requirements are not satisfied.

<sup>80</sup>Pub. L. No. 109–280. The PPA minimum funding rules for single-employer plans are generally effective for plan years beginning after December 31, 2007. Subsequent changes were made by the Worker, Retiree, and Employer Recovery Act of 2008 (“WRERA”), Pub. L. No. 110–458; the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 (“PRA 2010”), Pub. L. No. 111–192; and MAP–21, discussed further herein.

<sup>81</sup>The value of plan assets is generally reduced by any prefunding balance or funding standard carryover balance in determining minimum required contributions. A prefunding balance results from plan contributions that exceed the minimum required contributions. A funding standard carryover balance results from a positive balance in the funding standard account that applied under the funding requirements in effect before PPA. Subject to certain conditions, a prefunding balance or funding standard carryover balance may be credited against the minimum required contribution for a year, reducing the amount that must be contributed.

<sup>82</sup>If the plan has obtained a waiver of the minimum required contribution (a funding waiver) within the past five years, the minimum required contribution also includes the related waiver amortization charge, that is, the annual installment needed to amortize the waived amount in level installments over the five years following the year of the waiver.



minimum required contribution is the plan's target normal cost, reduced by the amount, if any, by which the net value of plan assets exceeds the plan's funding target.

*Shortfall amortization charge*

The shortfall amortization charge for a plan year is the sum of the annual shortfall amortization installments attributable to the shortfall bases for that plan year and the six previous plan years. Generally, if a plan has a funding shortfall for the plan year, a shortfall amortization base must be established for the plan year.<sup>83</sup> A plan's funding shortfall is the amount by which the plan's funding target exceeds the net value of plan assets. The shortfall amortization base for a plan year is: (1) the plan's funding shortfall, minus (2) the present value, determined using the segment interest rates (discussed below), of the aggregate total of the shortfall amortization installments that have been determined for the plan year and any succeeding plan year with respect to any shortfall amortization bases for the six previous plan years. The shortfall amortization base is amortized in level annual installments ("shortfall amortization installments") over a seven-year period beginning with the current plan year and using the segment interest rates (discussed below).<sup>84</sup>

The shortfall amortization base for a plan year may be positive or negative, depending on whether the present value of remaining installments with respect to amortization bases for previous years is more or less than the plan's funding shortfall. If the shortfall amortization base is positive (that is, the funding shortfall exceeds the present value of the remaining installments), the related shortfall amortization installments are positive. If the shortfall amortization base is negative, the related shortfall amortization installments are negative. The positive and negative shortfall amortization installments for a particular plan year are netted when adding them up in determining the shortfall amortization charge for the plan year, but the resulting shortfall amortization charge cannot be less than zero (that is, negative amortization installments may not offset normal cost).

If the net value of plan assets for a plan year is at least equal to the plan's funding target for the year, so the plan has no funding shortfall, any shortfall amortization bases and related shortfall amortization installments are eliminated.<sup>85</sup> As indicated above, if the net value of plan assets exceeds the plan's funding target, the excess is applied against target normal cost in determining the minimum required contribution.

<sup>83</sup> If the value of plan assets, reduced only by any prefunding balance if the employer elects to apply the prefunding balance against the required contribution for the plan year, is at least equal to the plan's funding target, no shortfall amortization base is established for the year.

<sup>84</sup> Under PRA 2010, employers were permitted to elect to use one of two alternative extended amortization schedules for up to two "eligible" plan years during the period 2008–2011. The use of an extended amortization schedule has the effect of reducing the amount of the shortfall amortization installments attributable to the shortfall amortization base for the eligible plan year. However, the shortfall amortization installments attributable to an eligible plan year may be increased by an additional amount, an "installment acceleration amount," in the case of employee compensation exceeding \$1 million, extraordinary dividends, or stock redemptions within a certain period of the eligible plan year.

<sup>85</sup> Any amortization base relating to a funding waiver for a previous year is also eliminated.

***Interest rate used to determine target normal cost and funding target***

The minimum funding rules for single-employer plans specify the interest rates and certain other actuarial assumptions that must be used in determining the present value of benefits for purposes of a plan's target normal cost and funding target.

Present value is generally determined using three interest rates ("segment" rates), each of which applies to benefit payments expected to be made from the plan during a certain period.<sup>86</sup> The first segment rate applies to benefits reasonably determined to be payable during the five-year period beginning on the first day of the plan year;<sup>87</sup> the second segment rate applies to benefits reasonably determined to be payable during the 15-year period following the initial five-year period; and the third segment rate applies to benefits reasonably determined to be payable after the end of the 15-year period. Under the funding rules as enacted in PPA ("PPA" rules), each segment rate is a single interest rate determined monthly by the Secretary of the Treasury, on the basis of a corporate bond yield curve, taking into account only the portion of the yield curve based on corporate bonds maturing during the particular segment rate period. The corporate bond yield curve used for this purpose reflects the average, for the 24-month period ending with the preceding month, of yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available. The Internal Revenue Service ("IRS") publishes the segment rates each month.

Under MAP-21, for plan years beginning after December 31, 2011, a segment rate determined under the PPA rules is adjusted if it falls outside a specified percentage range of the average segment rates for a preceding period. In particular, if a segment rate determined under the PPA rules is less than the applicable minimum percentage in the specified range, the segment rate is adjusted upward to match the minimum percentage. If a segment rate determined under the PPA rules is more than the applicable maximum percentage in the specified range, the segment rate is adjusted downward to match the maximum percentage. For this purpose, an average segment rate is the average of the segment rates determined under the PPA rules for the 25-year period ending September 30 of the calendar year preceding the calendar year in which the plan year begins. The Secretary is to determine average segment rates on an annual basis and may prescribe equivalent rates for any years in the 25-year period for which segment rates determined under the PPA rules are not available. The Secretary is directed to publish the average segment rates each month.

The specified percentage range (that is, the range from the applicable minimum percentage to the applicable maximum percentage)

<sup>86</sup> Solely for purposes of determining minimum required contributions, in lieu of the segment rates, an employer may elect to use interest rates on a yield curve based on the yields on investment grade corporate bonds for the month preceding the month in which the plan year begins (that is, without regard to the 24-month averaging described above) ("monthly yield curve"). If an election to use a monthly yield curve is made, it cannot be revoked without IRS approval.

<sup>87</sup> Subject to an exception for small plans with no more than 100 participants, the annual valuation date for a plan must be the first day of the plan year. Thus, except for small plans with valuation dates other than the first day of the plan year, the period for which the first segment rate applies begins on the valuation date.

for a plan year is determined by reference to the calendar year in which the plan year begins as follows:

- 90 percent to 110 percent for 2012,
- 85 percent to 115 percent for 2013,
- 80 percent to 120 percent for 2014,
- 75 percent to 125 percent for 2015, and
- 70 percent to 130 percent for 2016 or later.

### ***Funding-related benefit restrictions***

Special rules may apply to a plan if its funding target attainment percentage is below a certain level.<sup>88</sup> A plan's funding target attainment percentage for a plan year is the ratio, expressed as a percentage, that the net value of plan assets bears to the plan's funding target for the year. Because a plan's funding target is a component of the plan's funding target attainment percentage, the interest rate used in determining the plan's funding target generally applies also in determining the plan's funding target attainment percentage.<sup>89</sup>

Restrictions on benefit increases, certain types of benefit payments ("prohibited payments") and benefit accruals (collectively referred to as "benefit restrictions") may apply to a plan if the plan's adjusted funding target attainment percentage is below a certain level.<sup>90</sup> The plan's adjusted funding target attainment percentage is determined in the same way as its funding target attainment percentage, except that the net value of plan assets and the plan's funding target are both increased by the aggregate amount of purchases of annuities for employees, other than highly compensated employees, made by the plan during the two preceding plan years. Although anti-cutback rules generally prohibit reductions in benefits that have already been earned under a plan,<sup>91</sup> reductions required to comply with the benefit restrictions are permitted.

Under these rules, a prohibited payment generally means (1) any payment in excess of the monthly benefit amount paid under a single life annuity (plus any social security supplement), or (2) any payment for the purchase of an irrevocable commitment from an insurer to pay benefits. Prohibited payments generally may not be made if the plan's adjusted funding target attainment percentage is less than 60 percent. If a plan's adjusted funding target attainment percentage is at least 60 percent, but less than 80 percent, prohibited payments may be made, but subject to limits. In addition, prohibited payments may not be made during any period in which the plan sponsor is a debtor in a bankruptcy proceeding

<sup>88</sup> For example, funding target attainment percentage is used to determine whether a plan is in "at-risk" status, so that special actuarial assumptions ("at-risk assumptions") must be used in determining the plan's funding target and target normal cost. A plan is in at risk status for a plan year if, for the preceding year: (1) the plan's funding target attainment percentage, determined without regard to the at-risk assumptions, was less than 80 percent, and (2) the plan's funding target attainment percentage, determined using the at-risk assumptions (without regard to whether the plan was in at-risk status for the preceding year), was less than 70 percent. A similar test applies in order for an employer to be permitted to apply a prefunding balance against its required contribution. That is, for the preceding year, the ratio of the value of plan assets (reduced by any prefunding balance) must be at least 80 percent of the plan's funding target (determined without regard to the at-risk rules).

<sup>89</sup> The adjustments to the segment rates under MAP-21 do not apply for certain other purposes for which the segment rates are used, for example, in calculating the limits on deductible contributions to single-employer defined benefit plans under section 404.

<sup>90</sup> Code secs. 401(a)(29) and 436 and ERISA sec. 206(g).

<sup>91</sup> Code sec. 411(d)(6) and ERISA sec. 204(g).

under Federal or State law unless the plan's adjusted funding target attainment percentage is at least 100 percent.

### ***Annual funding notice***

The plan administrator of a single-employer defined benefit plan must provide an annual funding notice to each participant and beneficiary, each labor organization representing such participants or beneficiaries, and the Pension Benefit Guaranty Corporation ("PBGC").<sup>92</sup> In addition to the information required to be provided in all funding notices, in the case of a single-employer defined benefit plan, the notice must include (1) the plan's funding target attainment percentage for the plan year to which the notice relates and the two preceding plan years, (2) the value of the plan's assets and benefit liabilities (that is, the present value of benefits owed under the plan) for the plan year and the two preceding years, determined in the same manner as under the funding rules, and (3) the value of the plan's assets and benefit liabilities as of the last day of the plan year to which the notice relates, determined using the fair market value of plan assets (rather value determined under the funding rules) and, in computing benefit liabilities, the interest rates used in computing variable-rate PBGC premiums.<sup>93</sup>

Under MAP-21, additional information must be included in a single-employer plan's annual funding notice in the case of an applicable plan year. For this purpose, an applicable plan year is any plan year beginning after December 31, 2011, and before January 1, 2015, for which (1) the plan's funding target, determined using segment rates as adjusted to reflect average segment rates ("adjusted" segment rates), is less than 95 percent of the funding target determined without regard to adjusted segment rates, (2) the plan has a funding shortfall, determined without regard to adjusted segment rates, greater than \$500,000, and (3) the plan had 50 or more participants on any day during the preceding plan year. Specifically, the notice must include (1) a statement that MAP-21 modified the method for determining the interest rates used to determine the actuarial value of benefits earned under the plan, providing for a 25-year average of interest rates to be taken into account in addition to a two-year average, (2) a statement that, as a result of MAP-21, the plan sponsor may contribute less money to the plan when interest rates are at historical lows, and (3) a table showing, for the applicable plan year and each of the two preceding plan years,<sup>94</sup> the plan's funding target attainment percentage, funding shortfall, and the employer's minimum required contribution, each determined both using adjusted segment rates and without regard to adjusted segment rates.

<sup>92</sup> ERISA sec. 101(f), originally enacted by section 103 of the Pension Funding Equity Act of 2004, Pub. L. No. 108-218. Annual funding notice requirements, with some differences, apply also to multiemployer and multiple-employer plans.

<sup>93</sup> In applying the funding rules, the value of plan assets may be determined on the basis of average fair market values over a period of up to 24 months. PBGC variable-rate premiums are based on a plan's unfunded vested benefit liabilities, computed using the first, second and third segment rates as determined under the PPA rules (without adjustments under MAP-21), but based on a monthly corporate bond yield curve, rather than a yield curve reflecting average yields for a 24-month period.

<sup>94</sup> In the case of a preceding plan year beginning before January 1, 2012, only the plan's funding target attainment percentage, funding shortfall, and the employer's minimum required contribution determined without regard to adjusted segment rates are required to be provided.

### ***Reasons for Change***

The interest rates used in valuing pension liabilities are intended to reflect market interest rates. However, interest rates in recent years have been low compared to average interest rates over the past 25 years. Recent low interest rates result in higher values for pension liabilities and higher required contributions in the near term. MAP-21 modified the interest rates used in valuing pension liabilities to give employers the option to effectively spread out the higher contributions over a longer period of time than would otherwise have been required. The Congress believed that continued low interest rates made it appropriate to extend the policy enacted in MAP-21.

### ***Explanation of Provision***

#### ***Applicable minimum and maximum percentages and annual funding notice***

The provision revises the specified percentage ranges (that is, the range from the applicable minimum percentage to the applicable maximum percentage of average segment rates) for determining whether a segment rate must be adjusted upward or downward. Under the provision, the specified percentage range for a plan year is determined by reference to the calendar year in which the plan year begins as follows:

- 90 percent to 110 percent for 2012 through 2017,
- 85 percent to 115 percent for 2018,
- 80 percent to 120 percent for 2019,
- 75 percent to 125 percent for 2020, and
- 70 percent to 130 percent for 2021 or later.

In addition, for purposes of the additional information that must be provided in a funding notice for an applicable plan year, an applicable plan year includes any plan year that begins after December 31, 2011, and before January 1, 2020, and that otherwise meets the definition of applicable plan year.

#### ***Prohibited payments in bankruptcy***

Under the provision, the adjusted segment rates do not apply for purposes of whether prohibited payments may be made from a plan during a period in which the plan sponsor is a debtor in a bankruptcy proceeding under Federal or State law, that is, for purposes of determining whether the plan's adjusted funding target attainment percentage is at least 100 percent. Thus, the plan's adjusted funding target attainment percentage, determined without regard to the adjusted segment rates, must be at least 100 percent in order for prohibited payments to be made.

#### ***Periods for determining segment rates***

The provision revises the period of benefit payments to which the segment rates (or adjusted segment rates) apply. Under the provision, the first rate applies to benefits reasonably determined to be payable during the five-year period beginning on the plan's valuation date (rather than the first day of the plan year as under present law); the second segment rate applies to benefits reasonably determined to be payable during the 15-year period following

the initial five-year period; and the third segment rate applies to benefits reasonably determined to be payable after the end of the 15-year period.<sup>95</sup>

### ***Effective Date***

The provisions relating to the applicable minimum and maximum percentages and periods for determining segment rates are generally effective for plan years beginning after December 31, 2012. Under a special rule, an employer may elect, for any plan year beginning before January 1, 2014, not to have these provisions apply either (1) for all purposes for which the provisions would otherwise apply, or (2) solely for purposes of determining the plan's adjusted funding target attainment percentage in applying the benefit restrictions for that year. A plan will not be treated as failing to meet the requirements of the anti-cutback rules solely by reason of an election under the special rule.

The provision relating to prohibited payments in bankruptcy generally applies to plan years beginning after December 31, 2014, or, in the case of a plan maintained pursuant to one or more collective bargaining agreements, to plan years beginning after December 31, 2015. If certain requirements are met, a plan amendment made pursuant to the provision may be retroactively effective, the plan will be treated as being operated in accordance with its terms during the period before the amendment, and the plan will not be treated as failing to meet the requirements of the anti-cutback rules solely by reason of the amendment. In order for this treatment to apply, the amendment must be made pursuant to the provision (or pursuant to any regulation issued by the Secretary or the Secretary of Labor under the provision), and the amendment must be made by the last day of the first plan year beginning on or after January 1, 2016, or such later date as the Secretary prescribes. In addition, the plan must be operated as if the plan amendment were in effect during the period (1) beginning on the date the provision (or regulation) takes effect (or, in the case of a plan amendment not required by the provision or regulation, the effective date specified in the plan), and (2) ending on the last day of the first plan year beginning on or after January 1, 2016, or such later date as the Secretary prescribes (or, if earlier, the date the amendment is adopted). The amendment must also apply retroactively for that period.

## **D. Extension of Customs User Fees (sec. 2004 of the Act and sec. 58c(j)(3) of Title 19 of the United States Code)**

### ***Present Law***

Section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA") authorizes the Secretary of the Treasury to collect passenger and conveyance processing fees and the merchandise processing fees. Section 412 of the Homeland Security Act of 2002 authorizes the Secretary of the Treasury to delegate

<sup>95</sup>The provision does not change the requirement that the valuation date for plans other than certain small plans must be the first day of the plan year. Thus, the provision does not change these periods for plans for which the valuation date must be the first day of the plan year.

such authority to the Secretary of Homeland Security. COBRA has been extended on several occasions. The current authorization for the collection of the passenger and conveyance processing fees is through September 30, 2023. The current authorization for the collection of the merchandise processing fee is through September 30, 2023.

***Reasons for Change***

The Congress believed it was appropriate to extend the specified Customs user fees.

***Explanation of Provision***

The provision extends the passenger and conveyance processing fees and the merchandise processing fee authorized under Section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (“COBRA”) through September 30, 2024.

***Effective Date***

The provision is effective on the date of enactment (August 8, 2014).

**PART EIGHT: TRIBAL GENERAL WELFARE EXCLUSION  
ACT OF 2014 (PUBLIC LAW 113-168)<sup>96</sup>**

**A. Indian General Welfare Benefits (sec. 2 of the Act and  
new sec. 139E of the Code)**

***Present Law***

Except as otherwise provided under the Code, gross income means all income from whatever source derived. The general welfare doctrine excludes certain payments from gross income. Excludable payments generally consist of payments: (1) made from a governmental fund, (2) for the promotion of general welfare (on the basis of the need of the recipient), and (3) that do not represent compensation for services. Examples of excludable benefits include disaster relief, adoption assistance, housing and utility subsidies for low income persons, and government benefits paid to the blind.

Prior to 2012, there was some uncertainty concerning the application of the general welfare doctrine to certain benefits provided by Indian tribes to their members. Benefits that have been scrutinized by the IRS include payments for housing, cultural, education, and elder programs provided by Indian tribal governments. The issue is whether the tribal governments can provide such benefits tax-free to their members because they are addressing a social welfare need, without considering the financial need of the members. In response to requests from tribes to provide guidance on this issue, the IRS issued Notice 2012-75 and Revenue Procedure 2014-35 (herein collectively referred to as “Rev. Proc. 2014-35”),<sup>97</sup> which provides safe harbors under which the IRS will presume that the individual need requirement of the general welfare exclusion is met for benefits provided under certain Indian tribal governmental programs.

***Explanation of Provision***

The provision contains similar requirements to Rev. Proc. 2014-35 in terms of which benefits would qualify for exclusion under the general welfare doctrine, including that the benefits (1) are provided pursuant to a specific Indian tribal government program, (2) are available to any tribal member who meets certain guidelines, (3) are for the promotion of general welfare, (4) are not lavish or extravagant, and (5) are not compensation for services. The Act, however, does not provide specific examples of programs under which benefits would qualify for exclusion.

---

<sup>96</sup>H.R. 3043. The House passed H.R. 3043 on September 16, 2014. The Senate passed the bill without amendment on September 18, 2014. The President signed the bill on September 26, 2014.

<sup>97</sup>Notice 2012-75, 2012-51 I.R.B. 715; Rev. Proc. 2014-35, 2014-26 I.R.B. 1110.



The provision requires the Secretary of the Treasury (“Secretary”) to establish a Tribal Advisory Committee to advise on matters relating to the taxation of Indians. In consultation with the Committee, the Act requires the Secretary to establish and require training of IRS agents on Federal Indian law and training of tribal financial officers about the Act. The provision also requires the Secretary to suspend audits and examinations of Indian tribal governments and tribe members relating to the general welfare exclusion until this education has been completed. The Secretary may waive interest and penalties to the extent those penalties relate to excluding a payment under the general welfare exclusion.

***Effective Date***

The provision applies to taxable years for which the tribal member’s refund statute of limitations period has not expired. The provision contains a one-year waiver of the refund statute of limitations period in the event that the period expires before the end of the one-year period beginning on the date of enactment (September 26, 2014).

**PART NINE: CONSOLIDATED AND FURTHER CONTINUING APPROPRIATIONS ACT, 2015 (PUBLIC LAW 113-235)<sup>98</sup>**

**DIVISION M—EXPATRIATE HEALTH COVERAGE  
CLARIFICATION ACT OF 2014**

**A. Treatment of Expatriate Health Plans under ACA (sec. 3  
of the Act)**

***Present Law***

***Affordable Care Act***

The Patient Protection and Affordable Care Act (“PPACA”)<sup>99</sup> and the Health Care and Education Reconciliation Act of 2010 (“HCERA”),<sup>100</sup> enacted in March, 2010, are collectively referred to as the Affordable Care Act (“ACA”). The ACA made various changes to the law with respect to health insurance coverage in the individual and group markets and the law with respect to group health plans. The changes to the individual and group health insurance markets include, for example, the establishment of American Health Benefit Exchanges, mandatory community rating in health insurance premiums for the individual and small group market, guaranteed issue for purchasers of individual health insurance plans and insured group health plans, and a prohibition against preexisting condition limitations in health insurance plans, including group health plans. The ACA also requires individuals to maintain minimum essential health coverage and applicable large employers to offer minimum essential coverage to their employees. Finally, the ACA imposes new fees and excise taxes, including for example, an annual fee on health insurance providers and, effective for 2018, an excise tax on high cost employer-sponsored health coverage.

***Requirements for group health plans and individual insurance***

***Rules for group health plans in effect before the enactment of the ACA***

Prior to the enactment of ACA, an employer was not required to offer its employees coverage under a group health plan, but any coverage offered was required to satisfy certain requirements. A

<sup>98</sup>H.R. 83 (a bill relating to insular areas and freely associated states energy) passed the House on September 15, 2014. The bill passed the Senate with an amendment on September 18, 2014. The House passed the bill with an amendment on December 11, 2014. The Senate agreed to the House amendment on December 13, 2014. The President signed the bill on December 16, 2014.

<sup>99</sup>Pub. L. No. 111-148

<sup>100</sup>Pub. L. No. 111-152.

group health plan is a plan, including a self-insured plan, of, or contributed to by, an employer or employee organization to provide health care to the employees, former employees, the employer, others associated or formerly associated with the employer in a business relationship, or their families.<sup>101</sup>

The requirements for group health plans in effect prior to the enactment of ACA include limitations on exclusions on benefits for preexisting conditions, prohibition on discrimination against individuals based on health status or genetic information, guaranteed renewability of an employer's participation in a multiemployer plan (generally a plan providing benefits under collective bargaining agreements to employees of two or more unrelated employers) or multiple-employer welfare arrangement (generally a plan providing benefits to employees of two or more unrelated employers, but not under collective bargaining agreements), specified benefits for mothers and newborns, mental health parity, and coverage for students on medical leave of absence from school.<sup>102</sup> Compliance with these requirements is enforced through an excise tax.<sup>103</sup> These requirements continue to apply to group health plans after enactment of ACA. However, if one of these pre-ACA requirement conflicts with an ACA requirement, the ACA requirement applies.<sup>104</sup>

*Additional requirements for group health plans and individual health coverage added by the ACA*

The ACA amended the PHSa to add requirements to group health plans and individual health insurance coverage,<sup>105</sup> that, subject to certain exceptions, apply under the Code and ERISA to

<sup>101</sup> Sec. 5000(b)(1). By definition, a group health plan is a plan providing employment-related health benefits.

<sup>102</sup> These requirements for group health plans are contained in Chapter 100 of the Code, sections 9801 et seq. Certain group health plans (e.g., governmental plans and plans covering fewer than two active employees) and certain types of coverage are exempt from these Code requirements. Parallel requirements generally apply to group health plans of private employers under part 7 of Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. sec. 1181 et seq., to group health plans of State and local government employers under Title XXVII of the Public Health Service Act (the "PHSA"), 42 U.S.C. 300gg et seq., and to health insurance issued in connection with group health plans under ERISA and the PHSa. Mirror definitions of the term group health plan apply for purposes of ERISA and the PHSa. This definition is similar to the definition under section 5000(b)(1) of the Code. Under ERISA and the PHSa, a group health plan is an employee welfare benefit plan established or maintained by an employer or employee organization, or both, that provides medical care for participants or their dependents directly or through insurance, or otherwise. Similar requirements apply also under the Federal Employees Health Benefits Program.

<sup>103</sup> Sec. 4980D.

<sup>104</sup> Sec. 9815.

<sup>105</sup> The Centers for Medicare and Medicaid Services ("CMS") sent letters, dated July 16, 2014, to the insurance commissioners of each of the territories informing them that the Department of Health and Human Service has determined that certain ACA requirements in the PHSa do not apply to individual and group health insurance issuers in the United States territories, for example, guaranteed availability, community rating, medical loss ratio, and essential health benefits, but that the group health plan rules generally do apply to the territories. The letters indicated that the determination is based on the definition of "state" in Title I of the ACA. Section 1304(d) provides that, for purposes of title I of the ACA, state is defined as the 50 States and the District of Columbia, but the application of the group health plan rules to the territories is not based on this definition. The letters are available at: <http://www.cms.gov/CCIIO/Resources/Letters/Downloads/letter-to-Francis.pdf>;

<http://www.cms.gov/CCIIO/Resources/Letters/Downloads/letter-to-Ilagan.pdf>;

<http://www.cms.gov/CCIIO/Resources/Letters/Downloads/letter-to-Wayne.pdf>;

<http://www.cms.gov/CCIIO/Resources/Letters/Downloads/letter-to-Tanuvasa.pdf>;

<http://www.cms.gov/CCIIO/Resources/Letters/Downloads/letter-to-Igisomar.pdf>.

group health plans by cross-reference to the PHS provisions.<sup>106</sup> Some of the additional requirements are generally effective in 2010, specifically for plan years beginning on or after September 23, 2010 (six months after enactment of PPACA). Other requirements added by the ACA are effective beginning in 2014, specifically for plan years beginning on or after January 1, 2014.

The additional requirements under the ACA for group health plans and individual health insurance coverage (as applicable) are:

- Required coverage of adult children up to age 26 if the plan provides dependent coverage of children, but a plan is not required to cover a child of a child receiving dependent coverage;
- Required coverage of preventive health services with no cost-sharing (i.e., deductibles and co-pays);
- No lifetime limits or annual limits on benefits;
- No preexisting condition exclusions, and no waiting periods of more than 90 days;
- Guaranteed availability and renewability of coverage;
- Setting of premiums without regard to health status (commonly referred to as “community rating”) and provision of essential health benefits;<sup>107</sup>
- Prohibition on discrimination under an insured group health plan in favor of highly compensated individuals;<sup>108</sup>
- Additional choice of health care providers and access to certain services;
- Use of a uniform explanation of coverage and standardized definitions (commonly referred to as a summary of benefits and coverage or “SBC” and a uniform glossary);
- Required appeals process for benefit denials, including an internal appeal and external review;
- Prohibition on the rescission of coverage, except in the case of fraud or intentional misrepresentation of material fact, and required advance notice of cancellation of coverage;
- Premium rebates for purchasers of health insurance (not self-insured coverage) unless a specified percentage of premiums is spent on health care and activities that improve health care quality (commonly referred to as medical loss ratio or “MLR” rule);<sup>109</sup>

<sup>106</sup> Secs. 1001–1004, 1201, 1255 of PPACA, as amended by sections 10101 and 10103 of PPACA and section 2301(b) of HCERA. These requirements are cross-referenced in section 9815 and ERISA section 716.

<sup>107</sup> These requirements apply to individual insurance and insurance offered in the small group market, which, under section 1304(a)(3) and (b)(2) of PPACA generally means insurance for a group health plan of an employer with an average of at least one but not more than 100 employees.

<sup>108</sup> This ACA provision does not apply to self-insured health plans, which, under Code section 105(h), have been subject to nondiscrimination requirements since before ACA. These rules prohibit such a plan from discriminating (both as to eligibility for coverage and as to benefits provided under the plan) in favor of highly compensated individuals. Under IRS Notice 2011–1, 2011–2 I.R.B. 259, compliance with the ACA nondiscrimination prohibition for insured plans is not required until regulations or other guidance has been issued.

<sup>109</sup> The MLR is a measurement that measures the percentage of total premiums that insurance companies spend on health care and quality initiatives, and not on administration, marketing and profit. If a health insurer does not spend at least 80 percent of the premiums (or 85 percent in the case of the large group market) it receives on health care services and activities to improve health care quality, the insurer must rebate the difference. A special rule applies in calculating the MLR for expatriate policies. Issuers of expatriate policies apply a special circumstances adjustment to the numerator of their MLR by multiplying the total of the incurred claims plus expenditures for activities that improve health care quality by a factor of two beginning with the 2012 MLR reporting year. For purpose of this MLR calculation, expatriate policies

- Access to additional data about the particular health coverage, such as claims denials;
- Statutory standards for programs to promote health or prevent disease (commonly referred to as “wellness” programs);
- Consistent coverage for individuals participating in approved clinical trials; and
- Consistent treatment of health care providers.

*Temporary relief from ACA group health plan rules for expatriate plans*

For plan years ending on or before December 31, 2015, under transitional relief under Treasury guidance, expatriate health plans are treated as satisfying the group health plan requirements added by ACA, provided the group health plan continues to satisfy the group health plan requirements in effect prior to the enactment of ACA.<sup>110</sup> For purposes of this transitional relief, an expatriate health plan is an insured group health plan with respect to which enrollment is limited to primary insureds who reside outside of their home country for at least six months of the plan year (or across two consecutive plans years) and any covered dependents, and its associated group health insurance coverage.<sup>111</sup>

***Annual fee on health insurance providers***

Effective for 2014, an annual fee applies to any covered entity engaged in the business of providing health insurance with respect to United States (“U.S.”) health risks.<sup>112</sup> The aggregate annual fee for all covered entities is the applicable amount. The applicable amount is \$8 billion for calendar year 2014, \$11.3 billion for calendar years 2015 and 2016, \$13.9 billion for calendar year 2017, and \$14.3 billion for calendar year 2018. For calendar years after 2018, the applicable amount is indexed to the rate of premium growth.

The aggregate annual fee is apportioned among the providers based on a ratio designed to reflect relative market share of U.S. health insurance business. For each covered entity, the fee for a calendar year is an amount that bears the same ratio to the applicable amount as (1) the covered entity’s net premiums written during the preceding calendar year with respect to health insurance for any U.S. health risk, bears to (2) the aggregate net written premiums of all covered entities during such preceding calendar year with respect to such health insurance.

---

are policies that provide coverage for employees, substantially all of whom are: working outside of their country of citizenship; working outside of their country of citizenship and outside the employer’s country of domicile; or individuals who are not United States citizens and who are working in their home country.

<sup>110</sup> FAQs about the Affordable Care Act Implementation (Part XIII), prepared by the Departments of Labor (“DOL”), Health and Human Services (“HHS”) and the Treasury (“Treasury”), March 8, 2013, and available at <http://www.dol.gov/ebsa/faqs/faq-aca13.html>.

<sup>111</sup> Q&A–6 of Frequently Asked Questions about the Affordable Care Implementation (Part XVIII) and Mental Health Parity Implementation, prepared issued by DOL, HHS, and Treasury, January 9, 2014, and available at: <http://www.dol.gov/ebsa/faqs/faq-aca18.html>.

<sup>112</sup> Sec. 9010 of PPACA.

## ***Tax on individuals without minimum essential coverage***

### *Requirement to maintain coverage*

Effective for 2014, the ACA added a requirement to the Code that individuals be covered by a health plan that provides at least minimum essential coverage or be subject to a tax<sup>113</sup> for failure to maintain the coverage. If an individual is a dependent<sup>114</sup> of another taxpayer, the other taxpayer is liable for any tax for failure to maintain the required coverage with respect to the individual. The tax is imposed for any month that an individual does not have minimum essential coverage, unless the individual qualifies for an exemption for the month.<sup>115</sup>

### *Minimum essential coverage*

Minimum essential coverage includes government-sponsored programs, eligible employer-sponsored plans, plans in the individual market, grandfathered group health plans and grandfathered health insurance coverage, and other coverage as recognized by the Secretary of HHS in coordination with the Secretary of the Treasury. Certain individuals present or residing outside of the U.S.<sup>116</sup> and bona fide residents of territories of the U.S.<sup>117</sup> are deemed to maintain minimum essential coverage.

Minimum essential coverage does not include coverage that consists of certain excepted benefits.<sup>118</sup> Excepted benefits include: (1) coverage only for accident, or disability income insurance; (2) coverage issued as a supplement to liability insurance; (3) liability insurance, including general liability insurance and automobile liability insurance; (4) workers' compensation or similar insurance; (5) automobile medical payment insurance; (6) credit-only insurance; (7) coverage for on-site medical clinics; and (8) other similar insurance coverage, specified in regulations, under which benefits for medical care are secondary or incidental to other insurance benefits. Other excepted benefits that do not constitute minimum essential coverage if offered under a separate policy, certificate or contract of insurance include long term care, limited scope dental and vision benefits, coverage for a disease or specified illness, hospital indemnity or other fixed indemnity insurance or Medicare supplemental health insurance.

<sup>113</sup> Section 5000A.

<sup>114</sup> Sec. 152.

<sup>115</sup> Exemptions from the requirement to maintain minimum essential coverage are provided for the following: (1) an individual for whom coverage is unaffordable because the required contribution exceeds eight percent of household income, (2) an individual with household income below the income tax return filing threshold under section 6012(a), (3) a member of an Indian tribe, (4) a member of certain recognized religious sects or a health sharing ministry, (5) an individual with a coverage gap for a continuous period of less than three months, and (6) an individual who is determined by the Secretary of Health and Human Services to have suffered a hardship with respect to the capability to obtain coverage.

<sup>116</sup> This rule applies to any month that occurs during a period described in section 911(d)(1)(A) or (B) which is applicable to an individual. Such periods include: (1) for a United States citizen, an uninterrupted period which includes an entire taxable year during which the individual is a bona fide resident of a foreign country or countries, and (2) for a United States citizen or resident, a period of 12 consecutive months during which the individual is present in a foreign country at least 330 full days.

<sup>117</sup> Bona fide residence in a territory is determined under section 937(a). For this purpose, the territories include Puerto Rico, Guam, the Northern Mariana Islands, American Samoa, and United States Virgin Islands.

<sup>118</sup> Sec. 2791(c)(1)–(4) of PHSA (42 U.S.C. sec. 300gg–91(c)(1–4)). A parallel definition of excepted benefits is provided in section 9832(c)(1)–(4).

*Tax on failure to maintain minimum essential coverage*

The tax for failure to maintain minimum essential coverage for any calendar month is calculated as one-twelfth of the tax calculated as an annual amount. The annual amount is equal to the greater of the flat dollar amount or the excess income amount. The flat dollar amount is the lesser of sum of the individual annual dollar amounts for the members of the taxpayer's family and 300 percent of adult individual dollar amount. The excess income amount is a specified percentage of the excess of the taxpayer's household income for the taxable year over the threshold amount of income required for income tax return filing for that taxpayer. The total annual household payment may not exceed the national average annual premium for bronze level health plans offered through American Health Benefit Exchanges that year for the family size. The tax is phased in over the first three years. The individual adult annual dollar amount is phased in as follows: \$95 for 2014; \$325 for 2015; and \$695 in 2016.<sup>119</sup> For an individual who has not attained age 18, the individual annual dollar amount is one half of the adult amount. The specified percentage of income is phased in as follows: one percent for 2014; two percent in 2015; and 2.5 percent beginning after 2015.

***Premium assistance credit***

*In general*

Effective for 2014, the ACA added a refundable tax credit (the "premium assistance credit") to the Code which is available to eligible individuals and families who purchase health insurance through an American Health Benefit Exchange.<sup>120</sup> The premium assistance credit, which is refundable and payable in advance directly to the insurer, subsidizes the purchase of certain health insurance plans through an American Health Benefit Exchange.<sup>121</sup>

The premium assistance credit amount is generally the lower of (1) the premium for the qualified health plan in which the individual or family enrolls, and (2) the premium for the second lowest cost silver plan<sup>122</sup> in the rating area where the individual resides, reduced by the individual's or family's share of premiums.

*Minimum essential coverage and employer offer of health insurance coverage*

Generally, if an employee is offered minimum essential coverage<sup>123</sup> other than through the individual market, including employer-provided health insurance coverage, the individual is ineligible for the premium assistance credit. However, mere eligibility for employer-sponsored minimum essential coverage does not pre-

<sup>119</sup>For years after 2016, the \$695 amount is indexed to CPI-U, rounded to the next lowest multiple of \$50.

<sup>120</sup>Sec. 36B.

<sup>121</sup>Although the credit is generally payable in advance directly to the insurer, individuals may choose to pay the total health insurance premiums out-of-pocket and claim the credit at the end of the taxable year.

<sup>122</sup>Under section 1302(d) of PPACA, a qualified health plan is categorized by level (bronze, silver, gold or platinum), depending on its actuarial value, that is the percentage of the plan's share of the total costs of benefits under the plan. A silver level plan must have an actuarial value of 70 percent.

<sup>123</sup>As defined in section 5000A(f).

vent an individual from being eligible for the premium assistance credit if the employer-sponsored coverage is not affordable or does not provide minimum value. Coverage is affordable for this purpose if the employee's share of the premium for self-only employer-provided coverage is 9.5 percent or less of an employee's household income. A plan provides minimum value for this purpose if the plan's share of the total allowed cost of provided benefits is at least 60 percent of such costs.<sup>124</sup> Actual enrollment in employer-sponsored minimum essential coverage makes an individual ineligible for premium assistance credits even if the coverage is not affordable or does not provide minimum value.

### ***Shared responsibility for employers***

#### *General requirement*

Effective for 2014, the ACA also added to the Code liability for an assessable payment on any applicable large employer<sup>125</sup> if one or more of its full-time employees is certified to the employer as having received a premium assistance credit<sup>126</sup> or a cost-sharing reduction<sup>127</sup> for health insurance. The amount of the assessable payment depends on whether the employer offers its full-time employees and their dependents the opportunity to enroll in minimum essential coverage under a group health plan sponsored by the employer.<sup>128</sup> An employer that offers its full-time employees the opportunity to enroll in affordable minimum essential coverage that provides at least minimum value is not subject to the assessable payment.

An applicable large employer is generally defined as an employer having an average of at least 50 full-time employees during the preceding calendar year. For purposes of whether the employer has at least 50 full-time employees, besides the number of full-time employees, the employer must include the number of its full-time equivalent employees for a month, determined by dividing the aggregate number of hours of service of employees who are not full-time employees for the month by 120. In addition, in determining whether an employer is an applicable large employer, members of

<sup>124</sup> Guidance on the calculation of minimum value is provided in HHS regulations, 45 C.F.R. sec. 145. The regulations provide safe harbor methods for calculating whether a plan with certain standard features provides minimum value, but a plan containing non-standard features that are incompatible with the safe harbors may determine minimum value through an actuarial certification from a member of the American Academy of Actuaries. Further the regulations provide that a calculation of minimum value must be made using a standard population developed by HHS for such use and described summary statistics issued by HHS. The standard population must reflect the population covered by self-insured group health plans. Finally, in Notice 2014-69, HHS and Treasury indicate that they intend to provide in regulations that plans do not provide minimum value if the plan excludes substantial coverage for in-patient hospitalization services or physician services (or both). The notice provides that in the interim employees are not required to treat a plan not providing these services as providing minimum value for purposes of eligibility for the premium assistance credit.

<sup>125</sup> Sec. 4980H. Notice 2013-45, 2013-31 I.R.B. 116, Part III, Q&A-2, provides that no assessable payments under section 4980H will be assessed for 2014. In addition, no assessable payments for 2015 will apply to applicable large employers that have fewer than 100 full-time employees (taking into account full-time equivalent employees) and meet certain other requirements. Section XV.D.6 of the preamble to the final regulations under section 4980H, 79 Fed. Reg. 8544, 8574-8575, February 12, 2014.

<sup>126</sup> Sec. 36B.

<sup>127</sup> Sec. 1402 of the ACA.

<sup>128</sup> Liability is dependent on one or more full-time employees receiving a premium assistance credit or cost-sharing reduction, not on individuals related to employees, such as an employee's spouse or children.



the same controlled group, group under common control, and affiliated service group are treated as a single employer.<sup>129</sup>

*Amount of assessable payment*

The assessable payment for not offering minimum essential coverage is imposed monthly and is equal to the total number of full-time employees of the employer in excess of 30 during the applicable month (regardless of how many employees receive premium assistance credits or cost-sharing reductions) multiplied by one-twelfth of \$2,000.<sup>130</sup> The assessable payment for offering coverage that is not affordable or does not provide minimum value is imposed monthly and is equal to one-twelfth of \$3,000 for each full-time employee who receives a premium assistance credit or reduced cost-sharing.<sup>131</sup> However, the assessable payment in this case is limited to the amount of the tax that would apply if the employer did not offer coverage.

***Information reporting added by the ACA***

The ACA added certain new information reporting requirements related to the provision of health coverage. These include a requirement that employers report the value of employer-sponsored health coverage on Form W-2<sup>132</sup> and certain reporting requirements related to the enforcement of an individual's responsibility to maintain minimum essential coverage and an employer's responsibility to offer its full-time employees and their dependents the opportunity to enroll in employer-sponsored minimum essential coverage ("individual and employer responsibility reporting requirements"). Failure to comply results in reporting penalties.

*Reporting related to minimum essential coverage*

Effective beginning 2014, the ACA requires that every person that provides minimum essential coverage to an individual during a calendar year report certain health insurance coverage information to the IRS and furnish the same information to the covered individual.<sup>133</sup> The persons required to report are generally health insurance issuers or carriers for insured coverage, plan sponsors of self-insured group health plan coverage, and the executive department or agency that provides coverage under a government-sponsored program. However, a health insurance issuer is not required

<sup>129</sup>The rules for determining controlled group, group under common control, and affiliated service group under section 414(b), (c), (m) and (o) apply for this purpose.

<sup>130</sup>Only one 30-employee threshold is allowed when multiple employers are aggregated and treated as a single employer, such as for a controlled group of employers.

<sup>131</sup>For calendar years after 2014, both the \$2,000 and \$3,000 amount are increased by the percentage by which the average per capita premium for health insurance coverage in the United States for the preceding calendar year exceeds the average per capita premium for calendar year 2013.

<sup>132</sup>Notice 2012-9 provides guidance on this reporting requirement. The notice provides relief from the reporting requirement in certain situations. For example, in the case of 2012 Forms W-2 (and later years unless and until further guidance is issued), the notice provides that an employer is not subject to the reporting requirement if the employer was required to file fewer than 250 Forms W-2 for the preceding calendar year. As another example, the notice provides that an employer that contributes to the cost of health coverage provided under a multiemployer plan is not required to report that cost on the Form W-2.

<sup>133</sup>Sec. 6055 and Treas. Reg. sec. 1.6055-1 and -2. Pursuant to Treas. Reg. sec. 1.6055-1(j), and Notice 2013-45, reporting entities are not subject to penalties for failure to comply with this reporting requirement for coverage in 2014.

to report coverage in a qualified health plan in the individual market enrolled in through an American Health Benefit Exchange.

The information required to be reported includes: (1) the name, address, and employer identification number (“EIN”) of the entity required to file the report; (2) the name, address, and taxpayer identification number (“TIN”) of the primary insured (or other responsible individual); (3) the name and TIN of each other individual obtaining coverage under the health plan; (4) for each covered individual, the months for which, for at least one day, the individual was enrolled in coverage and entitled to receive benefits; and (5) any other information specified in forms or published guidance. In the case of coverage of an individual by a health insurance issuer under a group health plan, the report must also include the name, address, and EIN of the employer sponsoring the plan, whether the coverage is a qualified health plan enrolled in through the Small Business Health Options Program (“SHOP”) and the SHOP’s unique identifier.

*Reporting related to applicable large employers offering minimum essential coverage*

Effective for 2014, an applicable large employer subject to the requirement to offer minimum essential coverage to its employees is required to report certain health insurance coverage information to the IRS and furnish certain health-coverage-related statements to its full-time employees.<sup>134</sup> The information required to be reported to the IRS must include (1) the name, address and EIN of the applicable large employer; (2) the name and telephone number of the applicable large employer’s contact, (3) the calendar for which the information is reported; (4) a verification as to whether the applicable large employer offered to its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an employer-sponsored plan, by calendar month; (5) the months during the calendar year for which minimum essential coverage under the plan was available; (6) each full-time employee’s share of the lowest cost monthly premiums (self-only) for coverage providing minimum value offered to that full-time employee under an employer-sponsored plan, by calendar month, (7) the number of full-time employees for each month during the calendar year; (8) the name, address, and TIN of each full-time employee during the calendar year and the months, if any, during which the employee was covered under the plan; and (9) any other information prescribed in forms, instructions, or published guidance.

The information required to be furnished to each full-time employee is the e-mail address and employer identification number of the applicable large employer, and the information required to be reported to the IRS with respect to the full-time employee.

*Time for reporting*

The time for filing the return with the IRS and for furnishing the report to an individual or employee is the same for the individual and employer responsibility reporting requirements. For these two

<sup>134</sup> Sec. 6056 and Treas. Reg. secs. 301.6056–1 and –2. Pursuant to Treas. Reg. sec. 301.6056–1(j), and Notice 2013–45, reporting entities are not subject to penalties for failure to comply with this reporting requirement for coverage in 2014.

reporting requirements, the information must be provided to individuals or full-time employees by January 31 and must be filed with the IRS by February 28 (or in the case of electronic filing by March 31). An applicable large employer is permitted to combine the reporting with respect to its full-time employees for both reporting requirements.

*Electronic furnishing of reports to individuals*

The information furnished to individuals for both these reporting requirement may be provided electronically if the individual affirmatively consents to receiving the information electronically and certain other requirements are satisfied.<sup>135</sup> One of the other requirements is providing the individual, prior to, or at the time of the consent, a disclosure statement informing the individual that the information will be provided in a paper document if the individual does not consent, the scope and duration of the consent, the right to withdraw consent, the condition under which the information will cease to be furnished electronically, procedures for the individual to update the information needed to contact the individual, and hardware and software requirement for receiving the information electronically.

***Patient-Centered Outcomes Research Trust Fund Excise Taxes***

The ACA imposes excise taxes to fund the Patient-Centered Outcomes Research Trust Fund (“PCORI Fund taxes”).<sup>136</sup> These excise taxes are effective for policy years ending after September 30, 2012, and before October 1, 2019. For fiscal year 2014, the tax rate for specified health insurance policies is \$2.00 for each policy. For applicable self-insured plans, the tax rate for fiscal year 2014 is also \$2.00.<sup>137</sup> In both cases, the tax is determined by applying the applicable rate to the average number of lives covered under the policy or plan. After fiscal year 2014, each tax rate is indexed to reflect projected annual increases in the per capita amount of national health expenditures.

The taxes are imposed on the issuers of specified health insurance policies or plan sponsors of applicable self-insured health plans, including (with certain exceptions) governmental entities, and Federal programs for providing medical care. The taxes further are imposed both within the 50 States and the District of Columbia, and in all U.S. territories.<sup>138</sup>

A specified health insurance policy is an accident or health insurance policy (including a policy under a group health plan) that is issued with respect to individuals residing in the U.S. (including U.S. territories).<sup>139</sup>

An applicable self-insured health plan is any plan providing accident or health coverage if any portion of the coverage is provided other than through an insurance policy and such plan is established or maintained by (1) one or more employers for the benefit

<sup>135</sup> Treas. Reg. secs. 1.6055-2 and 301.6056-2.

<sup>136</sup> Sec. 4375-4377.

<sup>137</sup> For fiscal year 2013, a tax rate of \$1.00 applied to policies and plans.

<sup>138</sup> No amount of these taxes is to be covered over to any territory.

<sup>139</sup> A specified health insurance policy does not include a policy substantially all of the benefits of which are excepted benefits under section 9832(c).

of current or former employees, (2) one or more employee organizations for the benefit of current or former members, (3) a combination of (1) and (2), and (4) certain other types of entities. The plan sponsor of an applicable self-insured health plan is generally (1) in the case of a plan established or maintained by a single employer, the employer, and (2) in the case of a plan established or maintained by an employee organization, the employee organization.

***Excise tax on high cost employer-sponsored health coverage***

Effective for 2018, the ACA imposes an excise tax on the provider of applicable employer-sponsored coverage if the aggregate cost of the coverage for an employee (including a former employee, surviving spouse, or any other primary insured individual) exceeds a threshold amount (“high cost employer-sponsored health coverage”).<sup>140</sup> The tax is 40 percent of the amount by which the aggregate cost exceeds the threshold amount. For 2018, the annual threshold amount is \$10,200 for self-only coverage and \$27,500 for other coverage (such as family coverage), multiplied by the health cost adjustment percentage, and then increased by an age and gender adjusted excess premium amount.<sup>141</sup>

The excise tax is imposed on the provider of the employer-sponsored coverage (“coverage provider”). In the case of insured coverage (i.e., coverage under a policy, certificate, or contract issued by an insurance company), the health insurance issuer is liable for the excise tax. In the case of self-insured coverage, the person that administers the plan benefits is generally liable for the excise tax. In the case of employer contributions to an HSA or an Archer MSA, the employer is liable for the excise tax.

***Explanation of Provision***

***Exemption from ACA for qualified expatriate plans***

Under the provision, the provisions of the ACA<sup>142</sup> do not apply with respect to the following: expatriate health plans; employers with respect to expatriate health plans, solely in their capacity as plan sponsors for expatriate health plans; and expatriate health insurance issuers with respect to coverage offered by such issuers under expatriate health plans. Thus for example, the prohibition against lifetime limits does not apply to expatriate health plans, employers acting as plan sponsors with respect to these plans, and expatriate health insurance issuers with respect to coverage offered by such issuers under expatriate health plans. Further, for example, the PCORI Fund taxes do not apply to expatriate health plans.

<sup>140</sup> Sec. 4980I.

<sup>141</sup> The threshold is increased for coverage of certain individuals: qualified retiree and participants in a plan sponsored by an employer, the majority of whose employee are in a high risk profession or are lineman for electrical or communication cable lines. In determining the excess amount with respect to an employee (that is, the amount by which the cost of employer-sponsored coverage for the employee exceeds the threshold amount), the aggregate cost of all employer-sponsored coverage of the employee is taken into account. For this purpose, the cost of employer-sponsored coverage is generally determined under rules similar to the rules for determining the applicable premium for purposes of COBRA continuation coverage, except that any portion of the cost of coverage attributable to the excise tax is not taken into account. Cost is determined separately for self-only coverage and family coverage. Special valuation rules apply to retiree coverage, certain health FSAs, and contributions to HSAs and Archer MSAs.

<sup>142</sup> The exemption from the ACA does not apply to the provisions of subtitle A of Title II of HCERA, which includes only education provisions that are not health provisions.

However, as described below, there are certain ACA provisions that do apply to expatriate plans, employers in their capacity as sponsors of expatriate health plans, and health insurance issuers with respect to expatriate health plans.

***Qualified expatriate health plans and the requirements for individuals to maintain and applicable large employers to offer minimum essential coverage***

The provision does not provide an exemption for individuals from the requirements of the ACA including the requirement that individuals maintain minimum essential coverage. Further the provision specifically provides that there is no exemption for applicable large employers that sponsor expatriate health plans from the requirement that the employer offer all its full-time employees the opportunity to enroll in employer-sponsored minimum essential coverage.

However, the provision specifies that an offer of coverage under an expatriate health plan under a group health plan is an offer of employer-sponsored minimum essential coverage and, thus, if the coverage offered is affordable and provides minimum value, the employee is not eligible for premium assistance credits. Further, an employee who enrolls in an expatriate plan that is provided under a group health plan satisfies the requirement to have minimum essential coverage for purposes of the individual responsibility requirement and is not eligible for the premium assistance credit (even if the coverage is not affordable or does not provide minimum value).

In the case of individuals who are qualified expatriates based on their status as members of a group (as described below), an expatriate plan covering these individuals is deemed to provide minimum essential coverage based on being a plan in the individual market, and thus satisfies the requirement to maintain minimum essential coverage.

***Required reporting with respect to qualified expatriate coverage***

The exemption from the ACA does not apply to the individual and employer responsibility reporting requirements added by ACA, except that statements furnished to individuals with respect to expatriate health insurance may be provided through electronic media and the primary insured with respect to expatriate health insurance is deemed to have consented to receive the statements in electronic form, unless the individual explicitly refuses such consent.

***Treatment of qualified expatriates and expatriate health plan coverage under annual fee on health insurance providers***

For calendar years after 2015, for purposes of applying the annual fee on health providers, a qualified expatriate (and any spouse, dependent, or any other individual enrolled in the plan) enrolled in an expatriate health plan is not considered a U.S. health risk. Thus, for calendar years after 2015, the same amount of fee is assessed but, when the aggregate annual fee is apportioned

among the providers based on a ratio designed to reflect relative market share of U.S. health insurance business, coverage under an expatriate health plan is disregarded in determining both the numerator and the denominator of the ratio for calculating a provider's share of the business.

For calendar years 2014 and 2015, coverage under an expatriate health plan is taken into account if the coverage is otherwise for a U.S. health risk. However, the amount of the annual fee assessed on any expatriate health insurance issuer is limited to the amount which bears the same ratio to the fee amount determined by the Secretary of the Treasury with respect to the expatriate health insurance issuer for each of these calendar years (taking into account the expatriate health coverage) as (1) the amount of premiums taken into account with respect to such issuer for each such year, less the amount of premiums for its expatriate health plans so taken into account, bears to (2) the amount of premiums taken into account with respect to such issuer for the year. The fee assessed on any other issuer remains unchanged for 2014 and 2015. Thus, for 2014 and 2015, the total fees assessed on all issuers are less than the total otherwise specified in ACA (\$8 billion and \$11.3 billion, respectively).

***Application of high cost employer-sponsored coverage excise tax to expatriate health coverage***

The excise tax on high-cost employer-sponsored coverage applies to coverage under an employer-sponsored expatriate health plan for employees who are qualified expatriates because they are assigned to work in the U.S. temporarily, as described below. The high-cost employer-sponsored health coverage excise tax does not apply to employer-sponsored expatriate health plan coverage for employees who are qualified expatriates because they are transferred temporarily to the U.S., as described below.

***Definitions***

*Definition of qualified expatriate*

As described below, one of the required standards for expatriate health plan is that substantially all of the primary enrollees in such plan (or health coverage under the plan) are qualified expatriates with respect to such plan or coverage.

*Definition of qualified expatriate with respect to a group health plan*

Under the provision, there is a distinction in the definition of a qualified expatriate under a group health plan between individuals working in the U.S. temporarily and individuals working outside the U.S. for certain periods during a year. For individuals working temporarily in the U.S., a qualified expatriate is a primary insured in a group health plan whose skills, qualifications, job duties, or expertise is of a type that has caused his or her employer to transfer or assign him or her to the U.S. for a specific and temporary purpose or assignment tied to his or her employment. For this purpose, the term transfer means an employer has transferred an employee to perform services for a branch of the same employer or a

parent, affiliate, franchise, or subsidiary thereof. A further requirement for an individual working temporarily in the U.S. is that, in connection with the transfer or assignment, the primary insured must be reasonably determined by the plan sponsor to require access to health insurance and other related services and support in multiple countries, and is offered other multinational benefits on a periodic basis (such as tax equalization, compensation for cross border moving expenses, or compensation to enable the expatriate to return to their home country). For individuals working outside the U.S. for periods during the year, a qualified expatriate is a primary insured who is working outside of the U.S. for a period of at least 180 days in a consecutive 12-month period that overlaps with the plan year.

In determining whether a primary insured is a qualified expatriate, U.S. includes only the 50 States, the District of Columbia, and Puerto Rico. Thus, for purposes of determining whether an individual is transferred or assigned temporarily to the U.S. or is working outside the U.S., the territory of Puerto Rico is treated as part of the U.S. but the other territories are not part of the U.S.

*Qualified expatriate based on being a member of a group of similarly situated individuals*

A qualified expatriate also includes an individual who is a member of a group of similarly situated individuals, and the group is formed for the purpose of traveling or relocating internationally to service one or more of purposes permitted for certain tax-exempt organizations,<sup>143</sup> or similarly situated organizations or groups (such as students or religious missionaries). The group must not be formed primarily for the sale of health insurance coverage. Finally the group must be a group that the Secretary of Health and Human Services, in consultation with the Secretary of the Treasury and the Secretary of Labor, determines requires access to health insurance and other related services and support in multiple countries.

*Expatriate health plan*

The term expatriate health plan means a group health plan, health insurance coverage offered in connection with a group health plan, or health insurance coverage offered to certain groups of individuals that meets certain standards. All expatriate health plans must meet the following standards:

- Substantially all of the primary enrollees in such plan or coverage are qualified expatriates with respect to such plan or coverage. In applying this standard, an individual shall not be considered a primary enrollee if the individual is not a national of the U.S. and the individual resides in the country of which the individual is a citizen.
- Substantially all of the benefits provided under the plan or coverage are not excepted benefits.<sup>144</sup>

<sup>143</sup> The tax-exempt organizations are organizations exempt under sections 501(c)(3) and (4).

<sup>144</sup> For purposes of the definition of expatriate health plans, excepted benefits is defined under section 9832(c). This definition parallels the definition used under section 5000A(f)(3) which (as

- If an expatriate health plan or coverage provides dependent coverage of children, the plan or coverage must make such dependent coverage available for adult children until the adult child attains age 26, unless such individual is the child of a child receiving dependent coverage.<sup>145</sup>
- The plan or coverage must be issued by an expatriate health plan issuer, or administered by an administrator, that together with any other person in the expatriate health plan issuer's or administrator's controlled group,<sup>146</sup> has licenses to sell insurance in more than two countries, and, with respect to such plan, coverage, or company in the controlled group:
  - a. maintains network provider agreements that provide for direct claims payments, directly or through third party contracts, with health care providers in eight or more countries;
  - b. maintains call centers, directly or through third party contracts, in three or more countries and accepts calls from customers in eight or more languages;
  - c. processes (in the aggregate together with other plans or coverage it issues or administers) at least \$1 million in claims in foreign currency equivalents each year;
  - d. makes available (directly or through third party contracts) global evacuation/repatriation coverage;
  - e. maintains legal and compliance resources in three or more countries; and
  - f. offers reimbursements for items or services under such plan or coverage in the local currency in eight or more countries.

The standards for an expatriate health plan that is a group health plan or health insurance coverage offered in connection with a group health plan include the following:

- The plan or coverage provides coverage for inpatient hospital services, outpatient facility services, physician services, and certain emergency services (comparable to such emergency services coverage described in and offered under a service benefit plan for plan year 2009 offered through the Federal Employee Health Benefits program<sup>147</sup> in multiple countries as follows:
  - a. Under a group health plan for qualified expatriates temporarily assigned or transferred to the U.S., both in the U.S. and in the country or countries from which the individual was transferred or assigned (accounting for flexibility needed with existing coverage), and such other country or countries as the Secretary of HHS, in consultation with the Secretary of the Treasury and the Secretary of Labor, may designate (after taking into account the bar-

---

discussed above under present law) provides that minimum essential benefits does not include health insurance coverage which consists of coverage of excepted benefits.

<sup>145</sup> This standard for expatriate health coverage is the same as the ACA requirement for individual and group health plans that provide dependent coverage of children, as described in present law.

<sup>146</sup> For this purpose, controlled group is defined as for purposes of the annual fee on health insurance issuers.

<sup>147</sup> This is a plan described in 5 U.S.C. sec. 8903(1) for plan year 2009.



riers and prohibitions to providing health care services in the countries as designated).

b. For qualified expatriates working outside the U.S. for a minimum period, in the country or countries in which the individual is present in connection with the individual's employment, and such other country or countries as the Secretary of HHS, in consultation with the Secretary of the Treasury and the Secretary of Labor, may designate.

- The plan sponsor must reasonably believe that the benefits provided by the expatriate health plan satisfy a standard at least actuarially equivalent to required minimum value.<sup>148</sup>
- The plan or coverage, and the plan sponsor or expatriate health insurance issuer with respect to such plan or coverage, satisfies the requirements for group health plans in effect before the enactment of the ACA.<sup>149</sup>

The standards for an expatriate health plan that provides coverage to individuals who are qualified expatriates based on being members of a group of similarly situated individuals includes a requirement that the plan or coverage provide coverage for inpatient hospital services, outpatient facility services, physician services, and certain emergency services (comparable to such emergency services coverage described in and offered under a service benefit plan for plan year 2009 offered through the Federal Employee Health Benefits program) in the country or countries as the Secretary of HHS, in consultation with the Secretary of the Treasury and the Secretary of Labor, may designate. The standards for the expatriate health coverage for this group also include any pre-ACA requirements under the PHSA that apply to health insurance in the individual market.

#### *Other terms used in the provision*

A qualified expatriate issuer is a health insurance issuer that issues expatriate health plans. The terms group health plan, health insurance coverage, health insurance issuer, and plan sponsor are defined by reference to the definition of these terms provided in the PHSA. As described above, the definitions of group health plan and plan sponsor provided in the PHSA are generally the same as the definitions for these terms in ERISA and the Code.

#### **Regulatory authority**

Under the provision, the Secretaries of the Treasury, HHS, and Labor are authorized to promulgate regulations necessary to carry out this provision, including such rules as may be necessary to prevent inappropriate expansion of the application of the exclusions under this provision from the ACA and applicable regulations, and to amend existing annual reporting requirements or procedures to include applicable qualified expatriate health insurers' total number of expatriate plan enrollees.

<sup>148</sup>This standard incorporates by reference the standard for minimum value in section 36B that applies for purposes of determining whether an offer of employer-sponsored coverage causes and an individual to be ineligible for the premium assistance credit.

<sup>149</sup>The pre-ACA requirements for group health plans would apply to expatriate group health plans absent this requirement but including these requirements in the standards for expatriate group health plans also conditions the exemption from the ACA requirements for an expatriate group plan on satisfaction of the pre-ACA group health plan rules.

***Effective Date***

The provision is generally effective on the date of enactment (December 16, 2014) and applies only to expatriate health plans issued or renewed on or after July 1, 2015. However, as described above, a special rule applies with respect to the annual insurance fee for 2014 and 2015.

**DIVISION N—OTHER MATTERS****A. Tax Technical Correction to Treatment of Certain Health Organizations (sec. 2 of the Act and sec. 833 of the Code)*****Present Law***

Code section 833 provides three rules with respect to certain health organizations meeting statutory requirements: (1) the organization is taxable as if it were a stock property and casualty insurance company; (2) a 25-percent deduction for certain claims and expenses is allowed with respect to health business of the organization; and (3) an exception is allowed for such an organization from the application of the 20-percent reduction in the deduction for increases in unearned premiums that applies generally to property and casualty insurance companies. Code section 833 applies a medical loss ratio threshold.

***Explanation of Provision***

First, the technical correction provides that the only consequences for not meeting the medical loss ratio threshold are that the 25-percent deduction for claims and expenses and the exception from the 20-percent reduction in the deduction for unearned premium reserves are not allowed. The organization is, however, treated as if it were a stock property and casualty insurance company. Second, the technical correction provides that, in calculating the medical loss ratio, the organization includes both the cost of reimbursement for clinical services provided to the individuals they insure and the cost of activities that improve health care quality (not just the former). This determination is made on an annual basis and affects the application of the 25-percent deduction for that year.

***Effective Date***

The provision is effective for taxable years beginning after December 31, 2009.

## DIVISION O—THE MULTIEMPLOYER PENSION REFORM ACT OF 2014

### A. Amendments to Pension Protection Act of 2006

#### 1. Repeal of sunset of PPA funding rules (sec. 101 of the Act, sec. 221 of the Pension Protection Act of 2006, secs. 431–432 of the Code and secs. 304–305 of ERISA)

#### *Present Law*

##### *Multiemployer plans*

A multiemployer plan is a plan to which more than one unrelated employer contributes, that is established pursuant to one or more collective bargaining agreements, and that meets other requirements as specified by the Secretary of Labor.<sup>150</sup> Multiemployer plans are governed by a board of trustees consisting of an equal number of employer and employee representatives, referred to as the plan sponsor. In general, the level of contributions to a multiemployer plan is specified in the applicable collective bargaining agreements, and the level of plan benefits is established by the plan sponsor.

Like other private defined benefit plans, multiemployer defined benefit plans are subject to minimum funding requirements under the Code and ERISA.<sup>151</sup> An excise tax may be imposed on the employers maintaining the plan if the funding requirements are not met.<sup>152</sup> Certain changes were made to the funding requirements for multiemployer plans by the Pension Protection Act of 2006 (“PPA”).<sup>153</sup> Changes made by PPA are generally effective for plan years beginning after 2007.

##### *General funding requirements for multiemployer plans*

###### *Minimum required contributions*

In connection with the funding requirements for a multiemployer plan, a notional account called a “funding standard account” is maintained, to which specific charges and credits (including plan contributions) are made for each plan year the multiemployer plan is maintained. The minimum required contribution for a plan year is the amount, if any, needed so that the accumulated credits to the funding standard account as of that plan year are not less than the accumulated charges (that is, so the funding standard account does not have a negative balance). If, as of the close of a plan year, accumulated charges to the funding standard account exceed credits, the plan has an “accumulated funding deficiency” equal to the amount of the excess. For example, if, as of a plan year, the balance of charges to the funding standard account would be \$200,000 without any contributions, then a minimum contribution equal to

<sup>150</sup> Sec. 414(f) and ERISA sec. 2(37).

<sup>151</sup> Secs. 412 and 431 and ERISA secs. 302 and 304. Additional rules apply to multiemployer plans that are in reorganization or insolvent under sections 418–418E and ERISA sections 4241–4245.

<sup>152</sup> Sec. 4971.

<sup>153</sup> For further explanation of the funding rules applicable after PPA, see Part I.D of *Joint Committee on Taxation, Present Law and Background Relating to Qualified Defined Benefit Plans* (JCX–99–14), September 15, 2014, available at [www.jct.gov](http://www.jct.gov).

that amount is required to meet the minimum funding standard for the year (that is, to prevent an accumulated funding deficiency). If credits to the funding standard account exceed charges, a “credit balance” results. The amount of the credit balance, increased with interest, has the effect of reducing future required contributions.

*Funding method; charges and credits to the funding standard account*

In the case of a multiemployer plan, an acceptable actuarial cost method (referred to as a funding method) must be used to determine the elements included in its funding standard account for a year. Generally, a funding method breaks up the cost of benefits under the plan into annual charges to the funding standard account consisting of two elements for each plan year. These elements are referred to as (1) normal cost and (2) supplemental cost.

The plan’s normal cost for a plan year generally represents the cost of future benefits allocated to the year by the funding method used by the plan for current employees and, under some funding methods, for separated employees. Specifically, it is the amount actuarially determined that would be required as a contribution by the employer for the plan year in order to maintain the plan if the plan had been in effect from the beginning of service of the included employees and if the costs for prior years had been paid, and all assumptions (for example, interest and mortality) had been fulfilled. A plan’s normal cost for a plan year is charged to the funding standard account for that year.

The supplemental cost for a plan year is the cost of future benefits that would not be met by future normal costs, future employee contributions, or plan assets. The most common supplemental cost is that attributable to past service liability, which represents the cost of future benefits under the plan (1) on the date the plan is first effective, or (2) on the date a plan amendment increasing plan benefits is first effective. Other supplemental costs may be attributable to net experience losses (for example, worse than expected investment returns or actuarial experience), losses from changes in actuarial assumptions, and amounts necessary to make up funding deficiencies for which a waiver was obtained. Supplemental costs are amortized (that is, recognized for funding purposes) over a specified number of years (generally 15 years) by annual charges to the funding standard account over that period.

Factors that result in a supplemental loss can alternatively result in a gain that is recognized by annual credits to the funding standard account over a 15-year amortization period (in addition to a credit for contributions made for the plan year). These include a reduction in plan liabilities as a result of a plan amendment decreasing plan benefits, net experience gains (for example, better than expected investment returns or actuarial experience), and gains from changes in actuarial assumptions.

*Extensions of amortization periods and sunset*

Before and after PPA, the plan sponsor of a multiemployer plan may obtain from the Secretary of the Treasury (“Secretary”) an extension of up to 10 years of the amortization periods applicable in determining charges to the funding standard account. The exten-

sion may be granted by the Secretary if the Secretary determines that (1) the extension would carry out the purposes of ERISA and would provide adequate protection for participants under the plan and (2) the failure to permit the extension would (a) result in a substantial risk to the voluntary continuation of the plan or a substantial curtailment of pension benefit levels or employee compensation and (b) be adverse to the interests of plan participants in the aggregate. The sponsor must also provide satisfactory evidence that notice of the request, including certain information, has been provided to plan participants and beneficiaries, any employee organization representing participants, and the Pension Benefit Guaranty Corporation (“PBGC”).

Under PPA, in addition to an amortization period extension described above, the sponsor of a multiemployer plan certified as meeting certain criteria may apply for an amortization period extension of up to five years that is required to be approved by the Secretary (referred to as an automatic amortization period extension). Included with the application must be a certification by the plan’s actuary that (1) absent the extension, the plan would have an accumulated funding deficiency in the current plan year and any of the nine succeeding plan years, (2) the sponsor has adopted a plan to improve the plan’s funding status, (3) taking into account the extension, the plan is projected to have sufficient assets to timely pay its expected benefit liabilities and other anticipated expenditures, and (4) the required notice described above has been provided. The period of any automatic amortization period extension reduces the 10-year period for which an extension described above may be granted by the Secretary. Under PPA, the provision relating to automatic amortization period extensions does not apply with respect to any application submitted after December 31, 2014.<sup>154</sup>

#### *Shortfall funding method and sunset*

Certain plans may elect to determine the required charges to the funding standard account under the shortfall funding method. Under this method, the charges are computed on the basis of an estimated number of units of service or production for which a certain amount per unit is to be charged. The difference between the net amount charged under this method and the net amount that otherwise would have been charged for the same period is a shortfall loss or gain that is amortized over subsequent plan years.

In general, the funding method used with respect to a multiemployer plan may be changed only with approval of the Secretary. However, under PPA, certain multiemployer plans may adopt, use or cease using the shortfall funding method and the adoption, use, or cessation of use is deemed approved by the Secretary.<sup>155</sup> Plans are eligible if (1) the plan has not used the shortfall funding method during the five-year period ending on the day before the date the plan is to use the shortfall funding method; and (2) the plan is not operating under an amortization period extension and did not operate under an amortization period extension during the five-

<sup>154</sup> Sec. 431(d)(1)(C) and ERISA sec. 304(d)(1)(C).

<sup>155</sup> Sec. 201(b) of PPA.

year period. In general, plan amendments increasing benefit liabilities of the plan cannot be adopted while the shortfall funding method is in use. Under PPA, deemed approval of a multiemployer plan's adoption, use, or cessation of use of the shortfall funding method does not apply to plan years beginning after December 31, 2014.<sup>156</sup>

***Additional requirements relating to endangered or critical status***<sup>157</sup>

*In general*

Under PPA, additional funding-related requirements apply to a multiemployer defined benefit pension plan that is in endangered or critical status.<sup>158</sup> In connection with the endangered and critical rules, not later than the 90th day of each plan year, the actuary for any multiemployer plan must certify to the Secretary and to the plan sponsor whether or not the plan is in endangered or critical status for the plan year. If a plan is certified as being in endangered or critical status, notice of endangered or critical status must be provided within 30 days after the date of certification to plan participants and beneficiaries, the bargaining parties, the PBGC and the Secretary of Labor. Additional notice requirements apply in the case of a plan certified as being in critical status.

Various requirements apply to a plan in endangered or critical status, including adoption of and compliance with (1) a funding improvement plan in the case of a multiemployer plan in endangered status, and (2) a rehabilitation plan in the case of a multiemployer plan in critical status. In addition, restrictions on certain plan amendments, benefit increases, and reductions in employer contributions apply during certain periods.

In the case of a multiemployer plan in critical status, additional required contributions (referred to as employer surcharges) apply until the adoption of a collective bargaining agreement that is consistent with the rehabilitation plan. In addition, employers are relieved of liability for minimum required contributions under the otherwise applicable funding rules (and the related excise tax), provided that a rehabilitation plan is adopted and followed.<sup>159</sup> Moreover, subject to notice requirements, some benefits that would otherwise be protected from elimination or reduction may be eliminated or reduced in accordance with the rehabilitation plan.<sup>160</sup>

In the case of a failure to meet the requirements applicable to a multiemployer plan in endangered or critical status, the plan actuary, plan sponsor, or employers required to contribute to the plan

<sup>156</sup>Sec. 221(c) of PPA.

<sup>157</sup>Sec. 432 as enacted by sec. 212 of PPA, and ERISA sec. 305, as enacted by sec. 202 of PPA. The rules relating to endangered and critical status (including annual certification of status) apply only to multiemployer plans in effect on July 16, 2006. Thus, any discussion of these rules in this document applies to multiemployer plans in effect on July 16, 2006.

<sup>158</sup>Endangered status and critical status are defined in section 432(b)(1) and (2) and ERISA section 305(b)(1) and (2).

<sup>159</sup>Sec. 4971(g)(1)(A).

<sup>160</sup>The rules for multiemployer plans in critical status include the elimination or reduction of "adjustable benefits," which include some benefits that would otherwise be protected from elimination or reduction under the anti-cutback rules under section 411(d)(6) and ERISA section 204(g).

may be subject to an excise tax under the Code or a civil penalty under ERISA.<sup>161</sup>

*Sunset of endangered and critical rules*

The rules relating to endangered and critical status generally do not apply to plan years beginning after December 31, 2014.<sup>162</sup> However, if a multiemployer plan is operating under a funding improvement or rehabilitation plan for its last plan year beginning before January 1, 2015, that is, for its 2014 plan year, the multiemployer plan must continue to operate under the funding improvement or rehabilitation plan during any period after December 31, 2014, that the funding improvement or rehabilitation plan is in effect, and all of the Code and ERISA provisions relating to the operation of the funding improvement or rehabilitation plan continue in effect during that period.

***Explanation of Provision***

The provision repeals the PPA provisions under which the rules relating to automatic extensions of amortization periods, deemed approval of a multiemployer plan's adoption, use, or cessation of use of the shortfall funding method, and endangered and critical status cease to apply. As a result, these rules apply on a permanent basis.

***Effective Date***

The provision is effective on the date of enactment (December 16, 2014).

**2. Election to be in critical status (sec. 102 of the Act, sec. 432 of the Code and sec. 305 of ERISA)**

***Present Law***

Not later than the 90th day of each plan year, the actuary for any multiemployer plan must certify to the Secretary and to the plan sponsor whether or not the plan is in endangered or critical status for the plan year. If a plan is certified as being in endangered or critical status, notice of endangered or critical status must be provided within 30 days after the date of certification to plan participants and beneficiaries, the bargaining parties, the PBGC and the Secretary of Labor. Additional notice requirements apply in the case of a plan certified as being in critical status.

A multiemployer plan is in critical status for a plan year if, as of the beginning of the plan year, it meets any of the following definitions:

- The funded percentage of the plan<sup>163</sup> is less than 65 percent and the sum of (1) the market value of plan assets, plus (2) the present value of reasonably anticipated employer and

<sup>161</sup> Sec. 4971(g) and ERISA sec. 502(c)(8). In addition, certain failures are treated as a failure to file an annual report with respect to the multiemployer plan, subject to a civil penalty under ERISA.

<sup>162</sup> Sec. 221(c) of PPA.

<sup>163</sup> A plan's multiemployer funded percentage is the percentage determined by dividing the value of plan assets by the plan's accrued liability (that is, generally, the present value of plan benefits).

employee contributions for the current plan year and each of the six succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the six succeeding plan years (plus administrative expenses),

- (1) The plan has an accumulated funding deficiency for the current plan year, not taking into account any amortization period extensions, or (2) the plan is projected to have an accumulated funding deficiency for any of the three succeeding plan years (four succeeding plan years if the funded percentage of the plan is 65 percent or less), not taking into account any amortization period extensions,

- (1) The plan's normal cost for the current plan year, plus interest for the current plan year on the amount of unfunded benefit liabilities under the plan as of the last day of the preceding year, exceeds the present value of the reasonably anticipated employer contributions for the current plan year, (2) the present value of vested (that is, nonforfeitable) benefits of inactive participants is greater than the present value of vested benefits of active participants, and (3) the plan has an accumulated funding deficiency for the current plan year, or is projected to have an accumulated funding deficiency for any of the four succeeding plan years (not taking into account amortization period extensions), or

- The sum of (1) the market value of plan assets, plus (2) the present value of the reasonably anticipated employer contributions for the current plan year and each of the four succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the four succeeding plan years (plus administrative expenses).

The first plan year for which the plan is in critical status is referred to as the "initial critical year," which governs the timing of certain requirements and periods.

In making the determinations and projections applicable in determining and certifying endangered or critical status (or neither), the plan actuary must follow certain statutory standards. The actuary's projections generally must be based on reasonable actuarial estimates, assumptions, and methods that offer the actuary's best estimate of anticipated experience under the plan.<sup>164</sup> In addition, the plan actuary must make projections for the current and succeeding plan years of the current value of the assets of the plan and the present value of all liabilities to participants and beneficiaries under the plan for the current plan year as of the beginning of the year. The projected present value of liabilities as of the beginning of the year must be based on the most recent actuarial statement required with respect to the most recently filed annual report or the actuarial valuation for the preceding plan year. Any

<sup>164</sup> Under section 432(i)(8) and ERISA section 305(i)(8), for purposes of the endangered and critical rules, various actuarial computations are based upon the unit credit funding method, regardless of whether it is the funding method used in applying the general funding requirements to the plan.



projection of activity in the industry or industries covered by the plan, including future covered employment and contribution levels, must be based on information provided by the plan sponsor, which shall act reasonably and in good faith.

### ***Explanation of Provision***

#### ***Election of critical status***

Under the provision, if a multiemployer plan is not in critical status for a plan year, but is projected to be in critical status in any of the succeeding five years, as determined and certified by the plan actuary, the plan sponsor may elect critical status for the plan. An election of critical status must be made within 30 days after the date the plan actuary certifies the plan's status.

If a plan sponsor elects critical status for the plan, the plan year for which the election is made is treated as the first year for which the plan is in critical status, that is, the initial critical year, regardless of the date, if any, on which the plan first meets one of the otherwise applicable definitions of critical status. Thus, a certification for a later year that the plan is in critical status under one of the otherwise applicable definitions does not result in a new initial critical year. In addition, if a plan is in critical status as a result of an election, it remains in critical status until it meets the requirements for emergence from critical status (as discussed below).

#### ***Additional certification and notice requirements***

Under the provision, as part of the required annual certification of a multiemployer plan's status for the plan year, the plan actuary must certify whether the plan will be in critical status for any of the five succeeding plan years. For this purpose, the actuary's projections generally must be based on reasonable actuarial estimates, assumptions, and methods that offer the actuary's best estimate of anticipated experience under the plan. However, the other statutory standards applicable in determining and certifying a plan's status as described above may be disregarded, except that a multiemployer plan sponsor may not elect critical status for the plan based on a certification made without regard to those standards.

If a multiemployer plan sponsor elects critical status for the plan, notice of the election must be included in the notice of critical status provided to plan participants and beneficiaries, the bargaining parties, the PBGC and the Secretary of Labor. Notice of the election must also be provided to the Secretary not later than 30 days after the date of certification of the plan's status or such other time as the Secretary may prescribe.

If a plan is certified by the plan actuary as projected to be in critical status in any of the succeeding five years (but not for the current plan year) and the plan sponsor does not elect critical status for the plan, the plan sponsor must provide notice of projected critical status to the PBGC within 30 days of the certification.

### ***Effective Date***

The provision is effective for plan years beginning after December 31, 2014.

### **3. Clarification of rule for emergence from critical status (sec. 103 of the Act, sec. 432 of the Code and sec. 305 of ERISA)**

#### ***Present Law***

##### ***Extensions of amortization periods***

As discussed above, under the general funding rules applicable to multiemployer defined benefit plans, charges and credits to the funding standard account are determined as the amount needed to amortize costs, losses and gains over specified periods, referred to as amortization periods.

Before and after PPA, the plan sponsor of a multiemployer plan may obtain from the Secretary an extension of up to 10 years of the amortization periods applicable in determining charges to the funding standard account. Under PPA, in addition to an amortization period extension described above, the sponsor of a multiemployer plan certified as meeting certain criteria may apply for an amortization period extension of up to five years that is required to be approved by the Secretary (referred to as an automatic amortization period extension). The period of any automatic amortization period extension reduces the 10-year period for which an extension described above may be granted by the Secretary.<sup>165</sup>

##### ***Emergence from critical status***

A multiemployer plan is in critical status for a plan year if, as of the beginning of the plan year, it meets any of the following definitions:

- The funded percentage of the plan is less than 65 percent and the sum of (1) the market value of plan assets, plus (2) the present value of reasonably anticipated employer and employee contributions for the current plan year and each of the six succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the six succeeding plan years (plus administrative expenses),
- (1) The plan has an accumulated funding deficiency for the current plan year, not taking into account any amortization period extensions, or (2) the plan is projected to have an accumulated funding deficiency for any of the three succeeding plan years (four succeeding plan years if the funded percentage of the plan is 65 percent or less), not taking into account any amortization period extensions,
- (1) The plan's normal cost for the current plan year, plus interest for the current plan year on the amount of unfunded benefit liabilities under the plan as of the last day of the preceding year, exceeds the present value of the reasonably anticipated employer contributions for the current plan year, (2) the present value of vested benefits of inactive participants is greater than the present value of vested benefits of active par-

<sup>165</sup> Under PPA, the provision relating to automatic amortization period extensions does not apply with respect to any application submitted after December 31, 2014; however, as described in Part A.1, the 2014 sunset date is repealed by section 101 of the Act.

ticipants, and (3) the plan has an accumulated funding deficiency for the current plan year, or is projected to have an accumulated funding deficiency for any of the four succeeding plan years (not taking into account amortization period extensions), or

- The sum of (1) the market value of plan assets, plus (2) the present value of the reasonably anticipated employer contributions for the current plan year and each of the four succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the four succeeding plan years (plus administrative expenses).

If a multiemployer plan is certified in critical status, the plan sponsor must adopt a rehabilitation plan. In general, a rehabilitation plan is a plan consisting of actions, including options or a range of options to be proposed to the bargaining parties, formulated, based on reasonable anticipated experience and reasonable actuarial assumptions, to enable the multiemployer plan to cease to be in critical status within a certain period (generally 10 years), referred to as the rehabilitation period, and may include reductions in plan expenditures (including plan mergers and consolidations), reductions in future benefits accruals or increases in contributions, if agreed to by the bargaining parties, or any combination of these actions.<sup>166</sup> A rehabilitation plan must provide annual standards for meeting the requirements of the rehabilitation plan.

Under a specific rule, a multiemployer plan in critical status remains in critical status until a plan year for which the plan actuary certifies (in accordance with the annual certification requirements) that the plan is not projected to have an accumulated funding deficiency for the plan year or any of the nine succeeding plan years, without regard to the use of the shortfall method, but taking into account any amortization period extensions.<sup>167</sup> Thus, a multiemployer plan does not emerge from critical status unless (1) it no longer meets any of the definitions of critical status, and (2) the plan actuary makes the certification described in the preceding sentence with respect to the plan's not being projected to have an accumulated funding deficiency.<sup>168</sup>

### ***Explanation of Provision***

The provision amends the rule for emergence from critical status to provide a rule for plans in critical status generally and a special rule if a plan has an automatic amortization period extension.

Under the general rule, a plan in critical status remains in critical status until a plan year for which the plan actuary certifies (in accordance with the annual certification requirements) that the plan (1) does not meet any of the definitions of critical status, (2) is not projected to have an accumulated funding deficiency for the

<sup>166</sup> If the plan sponsor determines that, on exhaustion of all reasonable measures, the multiemployer plan cannot reasonably be expected to cease to be in critical status by the end of the rehabilitation period, the rehabilitation plan must consist of reasonable measures to cease to be in critical status at a later time or to forestall insolvency.

<sup>167</sup> Sec. 432(e)(4)(B) and ERISA sec. 305(e)(4)(B).

<sup>168</sup> See Prop. Treas. Reg. sec. 1.432(b)-1(c)(6).

plan year or any of the nine succeeding plan years, without regard to the use of the shortfall method but taking into account any amortization period extensions granted by the Secretary under the rules in effect either before or after PPA, and (3) is not projected to become insolvent for any of the 30 succeeding plan years.

Under the special rule, a plan in critical status that has an automatic amortization period extension is no longer in critical status (that is, the plan emerges from critical status) if the plan actuary certifies for a plan year (in accordance with the annual certification requirements) that the plan (1) is not projected to have an accumulated funding deficiency for the plan year or any of the 9 succeeding plan years, without regard to the use of the shortfall method but taking into account any automatic amortization period extension (but not taking into account any amortization period extensions granted by the Secretary), and (2) is not projected to become insolvent for any of the 30 succeeding plan years. Under the special rule, the plan is no longer in critical status, regardless of whether the plan meets any of the otherwise applicable definitions of critical status. If a plan emerges from critical status under the special rule, the plan does not reenter critical status for any subsequent plan year unless the plan (1) is projected to have an accumulated funding deficiency for the plan year or any of the nine succeeding plan years, without regard to the use of the shortfall method but taking into account any amortization period extensions (either automatic or granted by the Secretary) or (2) is projected to become insolvent for any of the 30 succeeding plan years.

#### ***Effective Date***

The provision is effective for plan years beginning after December 31, 2014.

#### **4. Endangered status not applicable if no additional action is required (sec. 104 of the Act, sec. 432 of the Code and sec. 305 of ERISA)**

##### ***Present Law***

Not later than the 90th day of each plan year, the actuary for any multiemployer plan must certify to the Secretary and to the plan sponsor whether or not the plan is in endangered or critical status for the plan year. If a plan is certified as being in endangered or critical status, notice of endangered or critical status must be provided within 30 days after the date of certification to plan participants and beneficiaries, the bargaining parties, the PBGC and the Secretary of Labor.

A multiemployer plan is in endangered status if the plan is not in critical status and, as of the beginning of the plan year, (1) the plan's funded percentage for the plan year is less than 80 percent, or (2) the plan has an accumulated funding deficiency for the plan year or is projected to have an accumulated funding deficiency in any of the six succeeding plan years (taking into account amortization period extensions).<sup>169</sup> A plan's multiemployer funded percent-

<sup>169</sup> A plan that meets the criteria in both (1) and (2) is in "seriously endangered" status. Special rules may apply to a plan in seriously endangered status.

age is the percentage determined by dividing the value of plan assets by the plan's accrued liability (that is, generally, the present value of plan benefits).

In the case of a multiemployer plan in endangered status, a funding improvement plan must be adopted within 240 days following the deadline for certifying a plan's status.<sup>170</sup> A funding improvement plan is a plan that consists of the actions, including options or a range of options, to be proposed to the bargaining parties, formulated to provide, based on reasonably anticipated experience and reasonable actuarial assumptions, for the attainment by the plan of certain requirements. The plan sponsor must update the funding improvement plan annually to reflect the circumstances of the multiemployer plan.

The funding improvement plan must provide that, during the funding improvement period, the plan will have a certain required increase in its funded percentage and will not have an accumulated funding deficiency for any plan year during the funding improvement period, taking into account amortization period extensions. In general, the plan's funded percentage must increase such that the funded percentage as of the close of the funding improvement period equals or exceeds a percentage equal to the sum of (1) the funded percentage at the beginning of the period, plus (2) 33 percent of the difference between 100 percent and the percentage in (1).<sup>171</sup> Thus, the difference between 100 percent and the plan's funded percentage at the beginning of the period must be reduced by at least one-third during the funding improvement period.

The funding improvement period is generally the 10-year period beginning on the first day of the first plan year beginning after the earlier of (1) the second anniversary of the date of adoption of the funding improvement plan, or (2) the expiration of collective bargaining agreements that were in effect on the due date for the actuarial certification of endangered status for the initial determination year and covering, as of that due date, at least 75 percent of the plan's active participants. The period ends if the plan is no longer in endangered status or if the plan enters critical status.

### ***Explanation of Provision***

Under the provision, a multiemployer plan that meets the otherwise applicable criteria for endangered status is treated as not being in endangered status for a plan year if (1) as part of the certification of endangered status for the plan year, the plan actuary certifies that the plan is projected to no longer meet the otherwise applicable criteria for endangered status as of the end of the tenth plan year ending after the plan year to which the certification relates, and (2) the plan was not in critical or endangered status for the immediately preceding plan year.<sup>172</sup> In that case, the plan sponsor must provide notice to the bargaining parties and the

<sup>170</sup> This requirement applies for the first plan year that the plan is in endangered status. If a plan sponsor fails to adopt a funding improvement plan by the end of the 240-day period after the required certification date, an ERISA penalty of up to \$1,100 a day applies.

<sup>171</sup> The requirements may vary for plans in seriously endangered status.

<sup>172</sup> The provision does not require the multiemployer plan to be projected to have achieved the increase in the plan's funded percentage by the end of the funding improvement plan that would be required under a funding improvement plan.

PBGC that the plan would be in endangered status but for treatment under the provision as not being in endangered status.

### ***Effective Date***

The provision is effective for plan years beginning after December 31, 2014.

### **5. Correct endangered status funding improvement plan target funded percentage (sec. 105 of the Act, sec. 432 of the Code and sec. 305 of ERISA)**

#### ***Present Law***

In the case of a multiemployer plan in endangered status, a funding improvement plan must be adopted within 240 days following the deadline for certifying a plan's status. The funding improvement plan generally must provide that—

- during the funding improvement period, the plan will have a certain required increase in its funded percentage, and
- the plan will not have an accumulated funding deficiency for any plan year during the funding improvement period.

A plan's multiemployer funded percentage is the percentage determined by dividing the value of plan assets by the plan's accrued liability (that is, generally, the present value of plan benefits). In general, in order for a funding improvement plan to be valid, it must reflect a projected increase in the multiemployer plan's funded percentage such that the funded percentage as of the close of the funding improvement period equals or exceeds a percentage equal to the sum of (1) the funded percentage at the beginning of the period, plus (2) 33 percent of the difference between 100 percent and the percentage in (1). Thus, the difference between 100 percent and the plan's funded percentage at the beginning of the period must be reduced by at least one-third during the funding improvement period.

The funding improvement period is generally the 10-year period beginning on the first day of the first plan year beginning after the earlier of (1) the second anniversary of the date of adoption of the funding improvement plan, or (2) the expiration of collective bargaining agreements that were in effect on the due date for the actuarial certification of endangered status for the initial determination year and covering, as of that due date, at least 75 percent of the plan's active participants. The period ends if the plan is no longer in endangered status or if the plan enters critical status.

As described above, the starting point for determining the required increase in the plan's funded percentage under a funding improvement plan is the plan's funded percentage as of the beginning of the funding improvement period, rather than its funded percentage as of the first plan year for which the plan is in endangered status. Thus, in order for a funding improvement plan to be developed, the plan's funded percentage must be projected to the beginning of the funding improvement period. In addition, any increase in the plan's funded percentage that occurs before the funding improvement period begins is not taken into account in determining whether a plan has achieved the required increase in funded percentage.

As also described above, under a funding improvement plan, the multiemployer plan must not be projected to have an accumulated funding deficiency in any year in the funding improvement period. Otherwise, a proposed funding improvement plan is invalid, even if, under the funding improvement plan, the multiemployer plan is projected not to have an accumulated funding deficiency as of the end of the funding improvement period.

### ***Explanation of Provision***

Under the provision, the starting point for determining the required increase in a multiemployer plan's funded percentage under a funding improvement plan is the plan's funded percentage as of the beginning of the first plan year for which the plan is in endangered status.

In addition, under a funding improvement plan, a multiemployer plan must not have an accumulated funding deficiency for the last plan year during the funding improvement period (rather than for any year). Thus, a funding improvement plan will not fail to be valid merely because the multiemployer plan is projected to have an accumulated funding deficiency for one or more years in the funding improvement period, other than the last year.<sup>173</sup>

### ***Effective Date***

The provision is effective for plan years beginning after December 31, 2014.

## **6. Conforming endangered status and critical status rules during funding improvement and rehabilitation plan adoption periods (secs. 106, 109(a)(2)(B) and 109(b)(2)(B) of the Act, sec. 432 of the Code and sec. 305 of ERISA)**

### ***Present Law***

#### ***In general***

Various operational restrictions apply with respect to a multiemployer plan that has been certified as being in endangered or critical status.

#### ***Endangered status***

##### ***During funding plan adoption period***

Certain restrictions apply with respect to a multiemployer plan in endangered status during the "funding plan adoption period," which is the period beginning on the date that the plan is first certified as being in endangered status for a plan year (referred to as the initial determination year) and ending on the day before the first day of the funding improvement period.<sup>174</sup>

During the funding plan adoption period, the plan sponsor may not accept a collective bargaining agreement or participation agree-

<sup>173</sup> The provision does not change the aspect of present law under which a multiemployer plan that has an accumulated funding deficiency (or, in some cases, a projected funding deficiency) is in critical status, rather than endangered status. Thus, if the multiemployer plan has an accumulated funding deficiency for any year in the funding improvement period, it will be in critical status, rather than endangered status.

<sup>174</sup> Sec. 432(d)(1)(A)–(C) and ERISA sec. 305(d)(1)(A)–(C).

ment that provides for (1) a reduction in the level of contributions for any participants, (2) a suspension of contributions with respect to any period of service, or (3) any new or indirect exclusion of younger or newly hired employees from plan participation. In addition, during the funding plan adoption period, except in the case of amendments required as a condition of qualified retirement plan status under the Code or to comply with other applicable law, no amendment may be adopted that increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits, or any change in the rate at which benefits vest (that is, become nonforfeitable) under the plan.

In the case of a plan in seriously endangered status, during the funding plan adoption period, the plan sponsor must take all reasonable actions (consistent with the terms of the plan and present law) that are expected, based on reasonable assumptions, to achieve an increase in the plan's funded percentage and a postponement of an accumulated funding deficiency for at least one additional plan year. These actions include applications for extensions of amortization periods, use of the shortfall funding method in making funding standard account computations, amendments to the plan's benefit structure, reductions in future benefit accruals, and other reasonable actions.

*After adoption of funding improvement plan (including funding improvement period)*

A multiemployer plan in endangered status may not be amended after the date of the adoption of a funding improvement plan so as to be inconsistent with the funding improvement plan.<sup>175</sup> In addition, a plan may not be amended after the date of the adoption of a funding improvement plan to increase benefits, including future benefit accruals, unless the plan actuary certifies that the benefit increase is consistent with the funding improvement plan and is paid for out of contributions not required by the funding improvement plan to meet the requirements of the funding improvement plan in accordance with the schedule contemplated in the funding improvement plan.<sup>176</sup>

During the funding improvement period, a plan sponsor may not accept a collective bargaining agreement or participation agreement with respect to the multiemployer plan that provides for (1) a reduction in the level of contributions for any participants, (2) a suspension of contributions with respect to any period of service, or (3) any new direct or indirect exclusion of younger or newly hired employees from plan participation.<sup>177</sup>

**Critical status**

*After notice of critical status*

In the case of a multiemployer plan in critical status, certain distributions and purchases may not be made as of the date notice of critical status is sent to participants and beneficiaries.<sup>178</sup> Specifi-

<sup>175</sup> Sec. 432(d)(2)(A) and ERISA sec. 305(d)(2)(A).

<sup>176</sup> Sec. 432(d)(2)(C) and ERISA sec. 305(d)(2)(C).

<sup>177</sup> Sec. 432(d)(2)(B) and ERISA sec. 305(d)(2)(B).

<sup>178</sup> Sec. 432(f)(2) and ERISA sec. 305(f)(2).



cally, payments in excess of a single life annuity (plus any social security supplement, if applicable) generally may not be made to a participant or beneficiary who begins receiving benefits after the notice is sent. In addition, annuity contracts to provide benefits may not be purchased.

*During rehabilitation plan adoption period*

Certain restrictions apply with respect to a multiemployer plan in critical status during the “rehabilitation plan adoption period,” which is the period beginning on the date that the plan is first certified as being in critical status for a plan year (referred to as the initial critical year) and ending on the day before the first day of the rehabilitation period.<sup>179</sup>

During the rehabilitation plan adoption period, the plan sponsor may not accept a collective bargaining agreement or participation agreement that provides for (1) a reduction in the level of contributions for any participants, (2) a suspension of contributions with respect to any period of service, or (3) any new direct or indirect exclusion of younger or newly hired employees from plan participation. In addition, during the rehabilitation plan adoption period, except in the case of amendments required as a condition of qualified retirement plan status under the Code or to comply with other applicable law, no amendment may be adopted that increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits, or any change in the rate at which benefits vest under the plan.

*After adoption of rehabilitation plan (including rehabilitation period)*

A multiemployer plan in critical status may not be amended after the date of adoption of a rehabilitation plan to be inconsistent with the rehabilitation plan.<sup>180</sup> In addition, a plan may not be amended after the date of the adoption of a rehabilitation plan to increase benefits (including future benefit accruals) unless the plan actuary certifies that the increase is paid for out of additional contributions not contemplated by the rehabilitation plan and, after taking into account the benefit increases, the plan is still reasonably expected to emerge from critical status by the end of the rehabilitation period on the schedule contemplated by the rehabilitation plan.<sup>181</sup>

***Explanation of Provision***

***Restrictions applicable to endangered and critical plans***

Under the provision, operational restrictions applicable under present law only to multiemployer plans in endangered status are eliminated. In addition, other operational restrictions are modified and, as modified, apply both to plans in endangered status and to plans in critical status. The operational restrictions apply as described below.

<sup>179</sup> Sec. 432(f)(4)(A)–(B) and ERISA sec. 305(f)(4)(A)–(B).

<sup>180</sup> Sec. 432(f)(1)(A) and ERISA sec. 305(f)(1)(A).

<sup>181</sup> Sec. 432(f)(1)(B) and ERISA sec. 305(f)(1)(B).

During the period beginning on the date of the certification of endangered status for the initial determination year, or of critical status for the initial critical year, and ending on the date of the adoption of a funding improvement plan, or rehabilitation plan, the plan sponsor may not accept a collective bargaining agreement or participation agreement with respect to the multiemployer plan that provides for a reduction in the level of contributions for any participants, a suspension of contributions with respect to any period of service, or any new direct or indirect exclusion of younger or newly hired employees from plan participation. In addition, during that period, no amendment of the plan that increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits, or any change in the rate at which benefits vest under the plan may be adopted unless the amendment is required as a condition of qualified retirement plan status under the Code or to comply with other applicable law.

After the date of adoption of a funding improvement plan or rehabilitation plan, a multiemployer plan in endangered or critical status may not be amended so as to be inconsistent with the funding improvement plan or rehabilitation plan, as applicable. In addition, after the date of the adoption of a funding improvement plan or rehabilitation plan, a multiemployer plan in endangered or critical status may not be amended to increase benefits, including future benefit accruals, unless the plan actuary certifies that the increase is paid for out of additional contributions not contemplated by the funding improvement or rehabilitation plan, as applicable, and, after taking into account the benefit increase, the multiemployer plan is still reasonably expected to (1) in the case of a plan in endangered status, meet the requirements of the funding improvement plan in accordance with the schedule contemplated in the funding improvement plan, and (2) in the case of a plan in critical status, emerge from critical status by the end of the rehabilitation period on the schedule contemplated by the rehabilitation plan.

#### ***Restrictions applicable only to critical plans***

The provision does not change the restrictions on certain distributions and purchases that apply to a multiemployer plan in critical status as of the date notice of critical status is sent to participants and beneficiaries. Thus, as under present law, payments in excess of a single life annuity (plus any social security supplement, if applicable) generally may not be made to a participant or beneficiary who begins receiving benefits after the notice is sent. In addition, annuity contracts to provide benefits may not be purchased.

#### ***Effective Date***

The provision is effective for plan years beginning after December 31, 2014.

**7. Corrective plan schedules when parties fail to adopt in bargaining (sec. 107 of the Act, sec. 432 of the Code and sec. 305 of ERISA)**

***Present Law***

Within 30 days of the adoption of a funding improvement plan in the case of a multiemployer plan in endangered status, or a rehabilitation plan in the case of a multiemployer plan in critical status, the plan sponsor must provide the bargaining parties schedules showing revised benefit structures, revised contribution structures, or both, which, if adopted, may reasonably be expected to enable the multiemployer plan to meet the requirements of the funding improvement or rehabilitation plan, as applicable. Certain schedules of contributions and benefits are required to be provided to the bargaining parties and, in each case, a particular schedule must be designated as the default schedule under the funding improvement or rehabilitation plan.<sup>182</sup> With the annual update of a funding improvement or rehabilitation plan, the plan sponsor must update any schedule of contribution rates under the funding improvement or rehabilitation plan to reflect the experience of the multiemployer plan.

If a collective bargaining agreement providing for contributions under a multiemployer plan that was in effect at the time the plan entered endangered or critical status expires, and after receiving one or more schedules from the plan sponsor, the bargaining parties fail to adopt a contribution schedule provided by the plan sponsor and consistent with the funding improvement or rehabilitation plan, the plan sponsor must implement the default schedule 180 days after the date on which the collective bargaining agreement expires.

Present law does not provide authority for a plan sponsor to implement an updated default schedule if, on expiration of a later bargaining agreement, the bargaining parties fail to agree on changes to contribution or benefit schedules necessary to meet the requirements of the funding improvement or rehabilitation plan.

***Explanation of Provision***

Under the provision, a schedule is to be implemented by the plan sponsor in certain instances on the expiration of a collective bargaining agreement subsequent to the collective bargaining agreement that was in effect at the time a multiemployer plan entered endangered or critical status.

Specifically, if a subsequent collective bargaining agreement expires while the multiemployer plan is still in endangered or critical status, as applicable, and after receiving one or more updated schedules from the plan sponsor, the bargaining parties fail to adopt a contribution schedule with terms consistent with the updated funding improvement or rehabilitation plan and a schedule received from the plan sponsor, the plan sponsor must implement the schedule applicable under the expired collective bargaining agreement (whether adopted by the parties or implemented by the

<sup>182</sup> A default schedule under a rehabilitation plan that includes reductions in future benefit accruals must not reduce the rate of benefit accruals below a specified minimum level.

plan sponsor), as updated and in effect on the date the collective bargaining agreement expires. The plan sponsor is to implement the updated schedule 180 days after the date on which the collective bargaining agreement expires.

### *Effective Date*

The provision is effective for plan years beginning after December 31, 2014.

## **8. Repeal of reorganization rules for multiemployer plans (sec. 108 of the Act, secs. 418–418E of the Code and secs. 4241–4245 of ERISA)**

### *Present Law*

Certain modifications to the funding rules apply to multiemployer plans in reorganization.<sup>183</sup> A plan is in reorganization for a year if the contribution needed to balance the charges and credits to its funding standard account exceeds its “vested benefits charge.” The plan’s vested benefits charge is generally the amount needed to amortize, in equal annual installments, unfunded vested benefits under the plan over (1) 10 years in the case of obligations attributable to participants in pay status, and (2) 25 years in the case of obligations attributable to other participants.

When a plan is in reorganization, an additional funding requirement, the “minimum contribution requirement” applies. Failure to meet the minimum contribution requirement results in an accumulated funding deficiency. In general, the minimum contribution requirement is an amount equal to the excess of (1) the sum of the plan’s vested benefit charge for the plan year and the increase in normal cost for the plan year attributable to plan amendments adopted while the plan was in reorganization, over (2) if applicable, a special credit (the “overburden credit”). A limitation applies to the minimum contribution requirement so that the rate of increase in contributions is generally limited to seven percent per year.

Subject to certain requirements (including notice to participants, any employee organization representing participants, and contributing employers), a multiemployer plan in reorganization may also be amended to reduce or eliminate accrued benefits (or benefit increases) that have been in effect for less than 60 months and are not guaranteed by the PBGC. Benefits may be reduced or eliminated notwithstanding the anti-cutback rules, which generally require that accrued benefits may not be decreased by plan amendment. Active and inactive participants must generally be treated similarly with respect to benefit reductions made under a plan in reorganization.

If a multiemployer plan is in reorganization, the plan sponsor is required to compare assets and liabilities to determine if the plan will become insolvent in the future. A plan is insolvent when its available resources in a plan year are not sufficient to pay the plan benefits for that plan year, or when the sponsor of a plan in reorganization reasonably determines, taking into account the plan’s recent and anticipated financial experience, that the plan’s available

<sup>183</sup> The reorganization rules predate the endangered and critical rules enacted under PPA.

resources will not be sufficient to pay benefits that come due in the next plan year. Notwithstanding the anti-cutback rules, an insolvent plan is required to reduce benefits to the level that can be provided by the plan's assets. However, benefits cannot be reduced below the level guaranteed by the PBGC. If a multiemployer plan is insolvent, the PBGC guarantee is provided in the form of unsecured loans to the plan (referred to as financial assistance), regardless of the plan's ability to repay the loan.<sup>184</sup> However, if a plan were later to recover from insolvency status, loans from the PBGC would have to be repaid.

### ***Explanation of Provision***

The provision repeals the reorganization rules for multiemployer plans. The provision also makes related modifications to the insolvency rules, including a requirement that, in the case of a multiemployer plan in critical status, the plan sponsor compare assets and liabilities to determine if the plan will become insolvent in the future. In addition, under the provision, the rules relating to benefit reductions under an insolvent plan do not apply to a multiemployer plan in critical and declining status that is operating under benefit suspensions (as discussed in Part D below).

### ***Effective Date***

The provision is effective for plan years beginning after December 31, 2014.

## **9. Disregard of certain contribution increases for withdrawal liability purposes (sec. 109 of the Act, sec. 432 of the Code and sec. 305 of ERISA)**

### ***Present Law***

#### ***Withdrawal liability***

An employer that withdraws from a multiemployer plan in a complete or partial withdrawal is generally liable to the plan in the amount determined to be the employer's withdrawal liability.<sup>185</sup> In general, a "complete withdrawal" means the employer has permanently ceased operations under the plan or has permanently ceased to have an obligation to contribute. A "partial withdrawal" generally occurs if, on the last day of a plan year, there is a 70-percent contribution decline for the plan year or there is a partial cessation of the employer's contribution obligation.

When an employer withdraws from a multiemployer plan, the plan sponsor is required to determine the amount of the employer's withdrawal liability, notify the employer of the amount of the withdrawal liability, and collect the amount of the withdrawal liability from the employer. In order to determine an employer's withdrawal liability, a portion of the plan's unfunded vested benefits is first allocated to the employer, generally in proportion to the employer's

<sup>184</sup> ERISA sec. 4261.

<sup>185</sup> ERISA secs. 4201–4225. Under ERISA section 4219(d), the prohibited transaction restrictions under ERISA section 406(a) do not apply to any action permitted or required under the withdrawal liability rules.

share of plan contributions for a previous period.<sup>186</sup> The amount of unfunded vested benefits allocable to the employer is then subject to various reductions and adjustments. An employer's withdrawal liability is generally payable, with interest, in level annual installments. However, the amount of the annual installments is limited, based on the amount of the employer's previous contributions to the plan and its highest previous rate of contribution, and the period over which installments are paid is limited to 20 years. An employer's withdrawal is the amount determined after application of these limits. In addition, the plan sponsor and the employer may agree to settle an employer's withdrawal liability obligation for a different amount.

***Disregard of employer surcharges and benefit reductions***

As of the first plan year a multiemployer plan is certified as being in critical status, certain plan contributions ("surcharges"), in addition to the contributions required under a collective bargaining agreement, apply to employers otherwise obligated to make a contribution for that plan year. For that first plan year, the surcharge is five percent of the contribution otherwise required to be made under the applicable collective bargaining agreement; for subsequent plan years, the surcharge is 10 percent of contributions otherwise required. The surcharge no longer applies with respect to employees covered by a collective bargaining agreement (or other agreement pursuant to which the employer contributes), beginning on the effective date of a collective bargaining agreement (or other agreement) that includes terms consistent with a schedule of contribution and benefit rates that complies with the rehabilitation plan. Surcharges may not be the basis for any benefit accrual under the plan, and surcharges are generally disregarded in determining the allocation of unfunded vested benefits to an employer for purposes of the employer's withdrawal liability.

In the case of a multiemployer plan in critical status, certain distributions may not be made as of the date notice of critical status is sent to participants and beneficiaries. Specifically, payments in excess of a single life annuity (plus any social security supplement, if applicable) may not be made to a participant or beneficiary who begins receiving benefits after the notice is sent. In addition, subject to providing advance notice, the plan sponsor may make certain reductions to adjustable benefits that the plan sponsor deems appropriate.<sup>187</sup> However, benefits generally may not be reduced for a participant or beneficiary who began to receive benefits before receiving notice of the multiemployer plan's critical status. The elimination of any prohibited forms of distribution and reductions in ad-

<sup>186</sup> Under 29 C.F.R. sec. 4211.2, for this purpose, unfunded vested benefits is the amount by which the value of vested benefits under the plan exceeds the value of plan assets.

<sup>187</sup> Adjustable benefits means (1) benefits, rights, and features under the plan, including post-retirement death benefits, 60-month guarantees, disability benefits not yet in pay status, and similar benefits; (2) any early retirement benefit or retirement-type subsidy and any benefit payment option (other than the qualified joint-and-survivor annuity); and (3) benefit increases that would not be eligible for PBGC guarantee on the first day of the initial critical year because the increases were adopted (or, if later, took effect) less than 60 months before that first day. However, the level of a participant's accrued benefit payable at normal retirement age may not be reduced. The ability to eliminate prohibited forms of distribution and to reduce adjustable benefits applies notwithstanding protection for distribution forms and previously accrued benefits under the anti-cutback rules, discussed in Part D below.

justable benefits are disregarded in determining a plan's unfunded vested benefits for withdrawal liability purposes.

### ***Explanation of Provision***

The provision consolidates the present-law rules for the disregard of benefit reductions and employer surcharges in determining withdrawal liability with respect to a multiemployer plan in critical status. In addition, under the provision, employer surcharges are disregarded in determining an employer's highest previous rate of contribution to the plan. The provision also adds new rules relating to the disregard of contribution increases under a funding improvement plan in the case of a multiemployer plan in endangered status or a rehabilitation plan in the case of a multiemployer plan in critical status.

Under the new rules, if an increase in contribution rate or other increase in contribution requirements (unless the other increase is due to increased levels of work, employment, or periods for which compensation is provided) is required or made to enable a multiemployer plan to meet the requirements of a funding improvement or rehabilitation plan, the increase is generally disregarded in determining the allocation of unfunded vested benefits to an employer and an employer's highest contribution rate. For this purpose, an increase in contribution rate or other increase in contribution requirements is deemed to be required or made to enable the multiemployer plan to meet the requirements of the funding improvement or rehabilitation plan, except for (1) increases in contribution requirements due to increased levels of work, employment, or periods for which compensation is provided or (2) additional contributions used to provide a permissible increase in benefits, including an increase in future benefit accruals.

The disregard of increases in contribution rate or other increases in contribution requirements generally ceases to apply as of the expiration date of the collective bargaining agreement in effect when the multiemployer plan emerges from endangered or critical status. However, after the plan emerges from endangered or critical status, increases in contribution rates for plan years during which the plan was in endangered or critical status that were disregarded while the plan was in endangered or critical status, continue to be disregarded in determining an employer's highest contribution rate for those plan years.

### ***Effective Date***

The provision is effective with respect to benefit reductions and increases in contribution rates or other required contribution increases that go into effect during plan years beginning after December 31, 2014, and to surcharges the obligation for which accrues on or after December 31, 2014.

**10. Guarantee for preretirement survivor annuities under multiemployer pension plans (sec. 110 of the Act and sec. 4022A of ERISA)**

***Present Law***

***QPSA requirement***

Under the Code and ERISA, if a married participant in a defined benefit plan dies before benefits begin, the plan generally must provide a benefit for the participant's surviving spouse in the form of a qualified preretirement survivor annuity ("QPSA"), which is a survivor annuity for the spouse that is at least 50 percent of the employee's accrued benefit.<sup>188</sup>

***PBGC guarantee of multiemployer plan benefits***

Termination of a multiemployer defined benefit pension plan can occur as a result of (1) the adoption of a plan amendment providing that participants receive no credit under the plan for any purpose for service with any employer after a date specified in the amendment (referred to as "freezing accruals"), (2) the adoption of a plan amendment causing the plan to become a defined contribution plan, or (3) the withdrawal of every employer from the plan or the cessation of the obligation of all employers to contribute to the plan (referred to as "mass withdrawal").<sup>189</sup>

If a terminated multiemployer plan becomes insolvent and plan assets are not sufficient to pay benefits at the level guaranteed by the PBGC, the PBGC will provide financial assistance as needed to pay benefits at the guarantee level.<sup>190</sup> The PBGC benefit guarantee level for multiemployer plans is the sum of 100 percent of the first \$11 of vested monthly benefits and 75 percent of the next \$33 of vested monthly benefits, multiplied by the participant's number of years of service.

The PBGC guarantee generally applies also to benefits payable to the surviving spouse of a deceased participant. However, in the case of a multiemployer plan, the PBGC guarantees QPSA benefits only in the case of a surviving spouse of a participant who dies before plan termination.

If a multiemployer plan that has not terminated becomes insolvent, similar rules apply, including the provision by the PBGC of financial assistance in an amount needed to provide benefits at the guarantee level.

***Explanation of Provision***

Under the provision, for purposes of the PBGC guarantee of benefits under a multiemployer plan, QPSA benefits under a multiemployer plan that becomes insolvent or is terminated are not treated as forfeitable solely because the participant has not died as of the date the plan becomes insolvent or the termination date of the

<sup>188</sup> Secs. 401(a)(11) and 417(c) and ERISA sec. 205(a) and (e).

<sup>189</sup> ERISA sec. 4041A. Unlike the termination of a single-employer plan (and except in the case of multiemployer plan terminations occurring before 1981), termination of a multiemployer plan does not of itself result in the end of the operation of the plan or in the PBGC's taking over the plan. Instead, the plan sponsor continues to administer the plan.

<sup>190</sup> ERISA secs. 4261 and 4281.



plan. Thus, QPSA benefits payable to the surviving spouse of a participant who dies after the plan becomes insolvent or is terminated are eligible for the PBGC guarantee (subject to guarantee limits).

### ***Effective Date***

The provision is effective with respect to multiemployer plan benefit payments becoming payable on or after January 1, 1985, except that it does not apply if a surviving spouse has died before the date of the enactment (December 16, 2014).

## **11. Required disclosure of multiemployer plan information (sec. 111 of the Act and secs. 101(k) and 107 of ERISA)**

### ***Present Law***

A plan administrator of a multiemployer plan must, within 30 days of a written request, provide a plan participant or beneficiary, employee representative, or employer that has an obligation to contribute to the plan with a copy of the following:

1. any periodic actuarial report (including any sensitivity testing) for any plan year that has been in the plan's possession for at least 30 days,
2. any quarterly, semi-annual, or annual financial report prepared for the plan by any plan investment manager or advisor or other plan fiduciary that has been in the plan's possession for at least 30 days, and
3. any application for an amortization period extension filed with the Secretary.

Any actuarial report, financial report, or amortization extension application provided to a participant, beneficiary, or employer generally must not include any individually identifiable information regarding any participant, beneficiary, employee, fiduciary, or contributing employer, or reveal any proprietary information regarding the plan, any contributing employer, or any entity providing services to the plan.

A person is not entitled to receive more than one copy of any actuarial or financial report or amortization extension application during any 12-month period. The plan administrator may make a reasonable charge to cover copying, mailing, and other costs of furnishing copies or notices, subject to a maximum amount that may be prescribed by regulations. Any information or notice required to be provided under the provision may be provided in written, electronic, or other appropriate form to the extent the particular form is reasonably available to the persons to whom the information is required to be provided.

In the case of a failure to comply with these requirements, the Secretary of Labor may assess a civil penalty of up to \$1,000 per day for each failure to provide a notice.

### ***Explanation of Provision***

The provision expands the types of documents that a multiemployer plan administrator is required to provide, within 30 days of a written request, to a participant or beneficiary, employee rep-

representative, or employer that has an obligation to contribute to the plan. Specifically, the plan administrator must provide a copy of the following:

1. the current plan document (including any amendments thereto),
2. the latest summary plan description of the plan,
3. the current trust agreement (including any amendments thereto) or any other instrument or agreement under which the plan is established or operated,
4. in the case of a request by an employer, any participation agreement of the employer with respect to the plan that relates to the employer's participation during the current or any of the five immediately preceding plan years,
5. the annual report filed for the plan for any plan year,
6. the annual funding notice for the plan for any plan year,
7. any periodic actuarial report (including any sensitivity testing) for any plan year that has been in the plan's possession for at least 30 days,
8. any quarterly, semi-annual, or annual financial report prepared for the plan by any plan investment manager or advisor or other plan fiduciary that has been in the plan's possession for at least 30 days,
9. audited financial statements of the plan for any plan year,
10. any application for an amortization period extension filed with the Secretary and the determination on the application, and
11. in the case of a plan in endangered or critical status for a plan year, the latest funding improvement or rehabilitation plan, and the contribution schedules applicable with respect to the funding improvement or rehabilitation plan (other than a contribution schedule applicable to a specific employer).

A person is not entitled to receive more than one copy of any document during any 12-month period. In addition, in the case of documents 5 through 9 listed above, a person is not entitled to receive a copy of a document that, as of the date on which the document request is received by the plan administrator, has been in the plan administrator's possession for six years or more. If the plan administrator provides a copy of a document listed above to any person on request, the plan administrator is considered as having met any obligation it may have under Title I of ERISA to furnish a copy of the same document to the person on request.

The provision amends the record-keeping requirements of Title I of ERISA to require the plan administrator to maintain a copy of any report required to be filed, including the documents listed above, and related records (as described in the record-keeping requirements) and to keep the records available for examination for at least six years. The provision amends the enforcement provisions of Title I of ERISA to allow an employee representative or an employer that has an obligation to contribute to the plan to bring a civil action to enjoin any act or practice that violates the requirement to provide the documents listed above or, in the case of an employer, to obtain appropriate equitable relief to redress a violation or to enforce the requirement to provide the listed documents.

### ***Effective Date***

The provision is effective for plan years beginning after December 31, 2014.

## **B. Multiemployer Plan Mergers and Partitions**

### **1. Mergers (sec. 121 of the Act and sec. 4231 of ERISA)**

#### ***Present Law***

#### ***Multiemployer plan insolvency***

If a multiemployer plan is insolvent (that is, the plan's available resources are not sufficient to pay benefits due under the plan), benefits must be reduced to the level that can be provided by plan assets. However, benefits cannot be reduced below the level guaranteed by the PBGC. If plan assets are insufficient to provide benefits at the PBGC guarantee level, the PBGC provides financial assistance as needed to pay benefits at the guarantee level.

#### ***Plan mergers and transfers***

Under present law, a plan sponsor generally may not cause a multiemployer plan to merge with one or more other multiemployer plans, or engage in a transfer of assets and liabilities to or from another multiemployer plan, unless the following requirements are met:

- the plan sponsor notifies the PBGC of the merger or transfer at least 120 days before the effective date of the merger or transfer,
- no participant's or beneficiary's accrued benefit will be lower immediately after the effective date of the merger or transfer than immediately before the effective date,
- the benefits of participants and beneficiaries are not reasonably expected to be subject to suspension as a result of plan insolvency, and
- an actuarial valuation of the assets and liabilities of each of the affected plans has been performed in accordance with PBGC regulations.<sup>191</sup>

#### ***PBGC Participant and Plan Sponsor Advocate***

Under ERISA, the PBGC board of directors selects a Participant and Plan Sponsor Advocate, who generally acts as a liaison between the PBGC, defined benefit plan sponsors, and participants in defined benefit plans trustee by the PBGC.<sup>192</sup>

### ***Explanation of Provision***

The provision amends the ERISA rules governing mergers of multiemployer plans by adding new rules relating to involvement by the PBGC. Under the provision, when requested by the plan sponsors of the relevant plans, the PBGC may take actions as it deems appropriate to promote and facilitate the merger of the plans. Before taking action, the PBGC must determine, after con-

<sup>191</sup> See PBGC regulations at 29 C.F.R. sections 4231.1–4231.10 for additional rules.

<sup>192</sup> ERISA sec. 4004.

sultation with the Participant and Plan Sponsor Advocate, that the merger is in the interests of the participants and beneficiaries of at least one of the plans and is not reasonably expected to be adverse to the overall interests of the participants and beneficiaries of any of the plans. Actions taken by the PBGC may include training, technical assistance, mediation, communication with stakeholders, and support with related requests to other government agencies.

In order to facilitate a merger that the PBGC determines is necessary to enable one or more of the plans involved to avoid or postpone insolvency, the PBGC may provide financial assistance to the merged plan if (1) one or more of the multiemployer plans participating in the merger is in critical and declining status (as described in Part D below), (2) the PBGC reasonably expects that the financial assistance will reduce the PBGC's expected long-term loss with respect to the plans involved and is necessary for the merged plan to become or remain solvent, (3) the PBGC certifies that its ability to meet existing financial assistance obligations to other plans will not be impaired by providing the financial assistance, and (4) the financial assistance is paid exclusively from the fund for basic benefits guaranteed for multiemployer plans.<sup>193</sup>

Not later than 14 days after the provision of financial assistance under the provision, the PBGC must provide notice thereof to the Committees of the House of Representatives ("House Committees") on Education and the Workforce and on Ways and Means and the Committees of the Senate ("Senate Committees") on Finance and on Health, Education, Labor, and Pensions.

### ***Effective Date***

The provision is effective for plan years beginning after December 31, 2014.

## **2. Partitions of eligible multiemployer plans (sec. 122 of the Act and sec. 4233 of ERISA)**

### ***Present Law***

#### ***Reorganization, withdrawal liability, insolvency***

Certain modifications to the funding rules apply to multiemployer plans in reorganization.<sup>194</sup> A plan is in reorganization for a year if the contribution needed to balance the charges and credits to its funding standard account exceeds its "vested benefits charge." The plan's vested benefits charge is generally the amount needed to amortize, in equal annual installments, unfunded vested benefits under the plan over (1) 10 years in the case of obligations attributable to participants in pay status, and (2) 25 years in the case of obligations attributable to other participants. When a plan is in reorganization, an additional funding requirement, the "minimum contribution requirement" applies. Failure to meet the min-

<sup>193</sup> Thus, other Federal funds, including funds from the PBGC single-employer plan program, may not be used for this purpose.

<sup>194</sup> As discussed in Part A.8 above, section 108 of the Act repeals the reorganization rules.

imum contribution requirement results in an accumulated funding deficiency.

If an employer withdraws from a multiemployer plan in a complete or partial withdrawal, so that the employer's obligation to contribute to the plan ceases or is reduced, the employer is generally liable to the plan in the amount determined to be the employer's withdrawal liability.<sup>195</sup> An employer's withdrawal liability is generally payable in level annual installments over a period of up to 20 years. Termination of a multiemployer plan does not end an employer's obligation to make withdrawal liability payments to the plan, though, in some circumstances, the amount of an employer's withdrawal liability may be redetermined.<sup>196</sup>

If a terminated multiemployer plan becomes insolvent and plan assets are not sufficient to pay benefits at the level guaranteed by the PBGC, the PBGC will provide financial assistance as needed to pay benefits at the guarantee level.<sup>197</sup>

The PBGC benefit guarantee level for multiemployer plans is the sum of 100 percent of the first \$11 of vested monthly benefits and 75 percent of the next \$33 of vested monthly benefits, multiplied by the participant's number of years of service. However, the guarantee level may be lower in the case of a benefit that has been in effect for fewer than 60 months, including benefits under a plan in effect for fewer than 60 months. In the case of a plan that is a successor to a previously established plan, the time that the successor plan is considered to be in effect for this purpose includes the time the previously established plan was in effect.

### ***Partition of a multiemployer plan***

Under present law, if certain conditions are met, a multiemployer plan may be partitioned, that is, separated into two plans, by order of the PBGC in response to an application by the plan sponsor. Before issuing a partition order, the PBGC must provide notice to the plan sponsor and to the plan participants and beneficiaries whose vested benefits will be affected by the partition of the plan. In addition, the PBGC must determine that—

- a substantial reduction in the amount of aggregate contributions under the plan has resulted or will result from a Federal bankruptcy case or proceeding with respect to an employer,
- the plan is likely to become insolvent,
- contributions will have to be increased significantly to meet the minimum contribution requirement in reorganization and prevent insolvency, and

<sup>195</sup> ERISA secs. 4201–4225.

<sup>196</sup> Under ERISA sec. 4041A, termination of a multiemployer defined benefit pension plan can occur as a result of (1) the adoption of a plan amendment providing that participants receive no credit under the plan for any purpose for service with any employer after a date specified in the amendment (referred to as “freezing accruals”), (2) the adoption of a plan amendment causing the plan to become a defined contribution plan, or (3) the withdrawal of every employer from the plan or the cessation of the obligation of all employers to contribute to the plan (referred to as “mass withdrawal”). Unlike the termination of a single-employer plan (and except in the case of multiemployer plan terminations occurring before 1981), termination of a multiemployer plan does not of itself result in the end of the operation of the plan or in the PBGC's taking over the plan. Instead, the plan sponsor continues to administer the plan.

<sup>197</sup> ERISA secs. 4261 and 4281.

- partition would significantly reduce the likelihood that the plan will become insolvent.<sup>198</sup>

The PBGC's partition order must provide for a transfer to the plan created by the partition of no more than the vested benefits of participants and beneficiaries that are directly attributable to service with the employer involved in the bankruptcy case or proceeding, as well as for the transfer of an equitable share of plan assets. The plan created by the partition order is treated as (1) a terminated plan with respect to which only the employer involved in the bankruptcy case or proceeding has withdrawal liability (and with respect to which a lien in favor of the PBGC may apply), and (2) a successor plan for purposes of determining the PBGC guarantee level.

### ***PBGC Participant and Plan Sponsor Advocate***

Under ERISA, the PBGC board of directors selects a Participant and Plan Sponsor Advocate, who generally acts as a liaison between the PBGC, defined benefit plan sponsors, and participants in defined benefit plans trustee by the PBGC.<sup>199</sup>

### ***Explanation of Provision***

The provision replaces the present-law partition rules with a new set of rules. Under the new rules, on application by the plan sponsor of an eligible multiemployer plan for a partition of the plan, the PBGC may order a partition of the plan. Not later than 30 days after submitting an application to the PBGC for partition of a plan, the plan sponsor must notify the participants and beneficiaries of the application, in the form and manner prescribed by PBGC regulations.

For purposes of the provision, a multiemployer plan is an eligible multiemployer plan if—

- the plan is in critical and declining status (as described in Part D below),
- the PBGC determines, after consultation with the Participant and Plan Sponsor Advocate, that the plan sponsor has taken (or is taking concurrently with an application for partition) all reasonable measures to avoid insolvency, including maximum benefit suspensions permitted in the case of a critical and declining plan, if applicable,
- the PBGC reasonably expects that a partition of the plan will reduce the PBGC's expected long-term loss with respect to the plan and is necessary for the plan to remain solvent,
- the PBGC certifies to Congress that the PBGC's ability to meet existing financial assistance obligations to other plans (including any liabilities associated with multiemployer plans that are insolvent or that are projected to become insolvent within 10 years) will not be impaired by the partition, and

<sup>198</sup> The PBGC may also bring an action in Federal court for a decree partitioning a multiemployer plan and appointing a trustee for the terminated portion of a partitioned plan. Subject to the notice and determinations required in order for the PBGC to order a partition, the court may issue a partition order.

<sup>199</sup> ERISA sec. 4004.

- the cost to the PBGC arising from the proposed partition is paid exclusively from the fund for basic benefits guaranteed for multiemployer plans.<sup>200</sup>

The PBGC must make a determination regarding a partition application not later than 270 days after the application is filed (or, if later, the date the application is completed) in accordance with PBGC regulations. Not later than 14 days after a partition order, the PBGC must provide notice thereof to the House Committees on Education and the Workforce and on Ways and Means and the Senate Committees on Finance and on Health, Education, Labor, and Pensions, as well as to any affected participants or beneficiaries.

The plan sponsor and the plan administrator of the eligible multiemployer plan (the “original” plan) before the partition are the plan sponsor and plan administrator of the plan created by the partition order (the “new” plan). For purposes of determining benefits eligible for guarantee by the PBGC, the new plan is a successor plan with respect to the original plan.

The PBGC’s partition order is to provide for a transfer to the new plan the minimum amount of the original plan’s liabilities necessary for the original plan to remain solvent. The provision does not provide for the transfer to the new plan of any assets of the original plan.

It is expected that the liabilities transferred to the new plan will be liabilities attributable to benefits of specific participants and beneficiaries (or a specific group or groups of participants and beneficiaries) as requested by the plan sponsor of the original plan and approved by the PBGC, up to the PBGC guarantee level applicable to each participant or beneficiary. Thus, benefits for such participants and beneficiaries up to the guarantee level will be paid by the new plan. For each month after the effective date of the partition that such a participant or beneficiary is in pay status, the original plan will pay a monthly benefit to the participant or beneficiary in the amount by which (1) the monthly benefit that would be paid to the participant or beneficiary under the terms of the original plan if the partition had not occurred (taking into account any benefit suspensions and any plan amendments after the effective date of the partition) exceeds (2) the amount of the participant’s or beneficiary’s benefit up to the PBGC guarantee level.

During the 10-year period following the effective date of the partition, the original plan must pay the PBGC premiums due for each year with respect to participants whose benefits were transferred to the new plan. The original plan must pay an additional amount to the PBGC if it provides a benefit improvement (as defined under the rules for plans in critical and declining status, discussed in Part D below) that takes effect after the effective date of the partition. Specifically, for each year during the 10-year period following the effective date of the partition, the original plan must pay the PBGC an annual amount equal to the lesser of (1) the total value of the increase in benefit payments for the year that is attributable to the benefit improvement, or (2) the total benefit payments from

<sup>200</sup> Thus, other Federal funds, including funds from the PBGC single-employer plan program, may not be used for this purpose.

the new plan for the year. This payment must be made to the PBGC at the time of, and in addition to, any other PBGC premium due from the original plan.

If an employer withdraws from the original plan within ten years after the date of the partition order, the employer's withdrawal liability will be determined by reference to both the original plan and the new plan. If the withdrawal occurs more than ten years after the date of the partition order, withdrawal liability will be determined only by reference to the original plan and not with respect to the new plan.

### ***Effective Date***

The provision is effective for plan years beginning after December 31, 2014.

## **C. Strengthening the Pension Benefit Guaranty Corporation (sec. 131 of the Act and sec. 4006(a)(3) of ERISA)**

### ***Present Law***

In order to protect plan participants and beneficiaries from losing retirement benefits, the PBGC, a corporation within DOL, was created under ERISA to provide an insurance program for benefits under most defined benefit plans maintained by private employers, including multiemployer defined benefit plans.<sup>201</sup>

In the case of multiemployer plans, the PBGC generally insures plan insolvency, regardless of whether the plan has terminated.<sup>202</sup> In general, a plan is insolvent when its available resources are not sufficient to pay the plan benefits for a plan year. If it appears that available resources will not support the payment of benefits at the level guaranteed by the PBGC (described below), the PBGC will provide the additional resources needed as a loan, referred to as financial assistance. If the plan recovers from insolvency, it must begin repaying the loans on reasonable terms in accordance with regulations.

The PBGC benefit guarantee level for multiemployer plans is the sum of 100 percent of the first \$11 of vested monthly benefits and 75 percent of the next \$33 of vested monthly benefits, multiplied by the participant's number of years of service.

The PBGC multiemployer program is financed through the payment of premiums by multiemployer defined benefit plans, which are held in an interest-bearing Treasury fund. In the case of a multiemployer plan, PBGC flat-rate premiums apply at a rate of \$12

<sup>201</sup> ERISA secs. 4001–4071. Governmental and church plans are generally not covered by the PBGC insurance programs. In the case of single-employer and multiple-employer defined benefit plans, the PBGC guarantees a certain level of benefits if a plan is terminated without sufficient assets to provide all benefits due under the plan.

<sup>202</sup> Under ERISA section 4041A, termination of a multiemployer defined benefit pension plan can occur as a result of (1) the adoption of a plan amendment providing that participants receive no credit under the plan for any purpose for service with any employer after a date specified in the amendment (referred to as “freezing accruals”), (2) the adoption of a plan amendment causing the plan to become a defined contribution plan, or (3) the withdrawal of every employer from the plan or the cessation of the obligation of all employers to contribute to the plan (referred to as “mass withdrawal”). Unlike the termination of a single-employer plan (and except in the case of multiemployer plan terminations occurring before 1981), termination of a multiemployer plan does not of itself result in the end of the operation of the plan or in the PBGC's taking over the plan. Instead, the plan sponsor continues to administer the plan.



per participant for 2014 with indexing thereafter. For 2015, the indexed rate is \$13 per participant.<sup>203</sup>

### ***Explanation of Provision***

Under the provision, in the case of a multiemployer plan, PBGC flat-rate premiums apply at a rate of \$26 per participant for 2015 with indexing thereafter.<sup>204</sup>

Not later than June 1, 2016, the PBGC is directed to submit a report to Congress that includes (1) an analysis of whether the premium levels enacted under the provision are sufficient for the PBGC to meet its projected benefit guarantee obligations under the multiemployer plan program for the 10- and 20-year periods beginning with 2015, including an explanation of the assumptions underlying the analysis, and (2) if the analysis concludes that the premium levels are insufficient to meet these obligations (or are in excess of the levels sufficient to meet these obligations), a proposed schedule of revised premiums sufficient to meet (but not exceed) these obligations.<sup>205</sup>

### ***Effective Date***

The provision is effective for plan years beginning after December 31, 2014.

## **D. Remediation Measures for Deeply Troubled Plans (sec. 201 of the Act, sec. 432 of the Code and sec. 305 of ERISA)**

### ***Present Law***

#### ***Anti-cutback requirements***

In general, a plan amendment may not reduce an employee's accrued benefit, eliminate an optional form of benefit (such as a lump-sum form), or eliminate or reduce early retirement benefits or retirement-type subsidies with respect to the employee's accrued benefit.<sup>206</sup> These restrictions are referred to as the anti-cutback requirements. Amendments generally are permitted only to reduce future rates of accrual, or, in the case of optional forms of benefits, early retirement benefits and retirement-type subsidies, eliminate or reduce them only with respect to benefits that accrue after the amendment. However, as discussed below, certain benefits may be

<sup>203</sup> Under ERISA section 4022A(f), the PBGC is directed every five years to determine the premium levels needed to support the existing guarantee levels for multiemployer plans, and whether the guarantee levels could be increased without increasing multiemployer plan premiums, and to report on its determinations to the House Committees on Ways and Means and on Education and Labor (now the House Committee on Education and the Workforce) and to the Senate Committees on Finance and Labor and Human Resources (now the Senate Committee on Health, Education, Labor, and Pensions). If such a report indicates that a premium increase is needed to support existing guarantee levels, by March 31 of any calendar year in which congressional action under section 4022A(f) is requested, the PBGC is directed to submit to the Committees (1) changes to the guarantee schedule as would be needed in the absence of premium increases, (2) premium increases needed to support existing guarantee levels, and (3) a combination of changes to the guarantee schedule at levels higher than under (1) with corresponding premiums increases, but lower than under (2).

<sup>204</sup> For fiscal years 2016 through 2020, certain multiemployer premium amounts are to be placed in a noninterest-bearing account and any financial assistance provided to multiemployer plans is to be withdrawn proportionately from the noninterest-bearing account and other accounts within the multiemployer plan fund.

<sup>205</sup> This report is required in addition to any report required under ERISA section 4022A.

<sup>206</sup> Sec. 411(d)(6) and ERISA sec. 204(g).

reduced or eliminated in the case of an underfunded multiemployer defined benefit plan. In addition, Treasury regulations may provide exceptions to the prohibition on eliminating an optional form of benefit.

***Exceptions to anti-cutback protection for multiemployer plan benefits***

*Multiemployer plans in critical status*

Not later than the 90th day of each plan year, the actuary for any multiemployer plan must certify to the Secretary and to the plan sponsor whether or not the plan is in endangered or critical status for the plan year. If a plan is certified as being in endangered or critical status, notice of endangered or critical status must be provided within 30 days after the date of certification to plan participants and beneficiaries, the bargaining parties, the PBGC and the Secretary of Labor. If a plan is in critical status, the notice of critical status must include an explanation of the possibility that adjustable benefits may be reduced (as discussed below) for participants and beneficiaries whose benefit commencement date is on or after the date the notice is provided for the first plan year for which the plan is in critical status.

In the case of a multiemployer plan in critical status, notwithstanding the anti-cutback rules, certain distributions may not be made as of the date notice of critical status is sent to participants and beneficiaries; thus, those forms of distribution may be eliminated. Specifically, payments in excess of a single life annuity (plus any social security supplement, if applicable) may not be made to a participant or beneficiary who begins receiving benefits after the notice is sent.

In addition, subject to providing advance notice, notwithstanding the anti-cutback rules, the plan sponsor of a plan in critical status may make certain reductions to adjustable benefits that the plan sponsor deems appropriate.<sup>207</sup> However, benefits generally may not be reduced for a participant or beneficiary who began to receive benefits before receiving notice of the multiemployer plan's critical status.

Adjustable benefits means (1) benefits, rights, and features under the plan, including post-retirement death benefits, 60-month guarantees, disability benefits not yet in pay status, and similar benefits; (2) any early retirement benefit or retirement-type subsidy and any benefit payment option (other than the qualified joint-and-survivor annuity); and (3) benefit increases that would not be eligible for PBGC guarantee on the first day of the initial critical year because the increases were adopted (or, if later, took effect) less than 60 months before such first day. Adjustable benefits that are otherwise protected under the anti-cutback rules, such as early retirement benefits, retirement-type subsidies and optional forms of benefit, may be reduced notwithstanding the anti-cutback rules. However, the level of a participant's accrued benefit payable at normal retirement age may not be reduced.

<sup>207</sup> In some circumstances, reductions in adjustable benefits may be required in order to enable a multiemployer plan to meet the requirements of its rehabilitation plan, as described in Part A.3.

No adjustable benefits may be reduced unless 30 days advance notice is given to plan participants and beneficiaries, any employer that has an obligation to contribute to the plan, and any employee organization that, in collective bargaining, represents plan participants employed by a contributing employer. The notice must contain sufficient information to enable participants and beneficiaries to understand the effect of any reduction of their benefits, including an estimate (on an annual or monthly basis) of any affected adjustable benefit that a participant or beneficiary would otherwise have been eligible for, and information as to the rights and remedies of plan participants and beneficiaries as well as how to contact DOL for further information and assistance where appropriate.

The required notice must be provided in a form and manner prescribed by the Secretary in consultation with the Secretary of Labor, must be written in a manner so as to be understood by the average plan participant, and may be provided in written, electronic, or other appropriate form to the extent such form is reasonably accessible to persons to whom the notice is required to be provided. The Secretary is to establish a model notice that a plan sponsor may use to meet the notice requirements.

*Multiemployer plans in reorganization or insolvency*

Subject to certain requirements (including notice to participants and beneficiaries, any employee organization representing participants, and contributing employers), notwithstanding the anti-cut-back rules, a multiemployer plan in reorganization may be amended to reduce or eliminate benefits or benefit increases that have been in effect for less than 60 months and are not guaranteed by the PBGC.<sup>208</sup> Active and inactive participants generally must be treated similarly with respect to benefit reductions made under a plan in reorganization.

Benefits under a multiemployer plan may be reduced (or suspended) if the plan is insolvent.<sup>209</sup> A multiemployer plan is insolvent when its available resources in a plan year are not sufficient to pay the plan benefits for that plan year, or when the sponsor of a plan in reorganization reasonably determines, taking into account the plan's recent and anticipated financial experience, that the plan's available resources will not be sufficient to pay benefits that come due in the next plan year. Notwithstanding the anti-cut-back rules, an insolvent plan is required to reduce benefits to the level that can be covered by the plan's assets.<sup>210</sup> However, benefits cannot be reduced below the level guaranteed by the PBGC. If a multiemployer plan is insolvent, the PBGC guarantee is provided

<sup>208</sup> Sec. 418D and ERISA sec. 4244A. As discussed in Part A.8, section 108 of the Act repeals the reorganization rules.

<sup>209</sup> Sec. 418E and ERISA sec. 4245.

<sup>210</sup> If a multiemployer plan is in reorganization, the plan sponsor is required periodically to compare assets and liabilities to determine whether the plan will become insolvent within a certain period. If the plan sponsor determines that the plan may become insolvent, the plan sponsor must provide notice to the Secretary, the PBGC, participants and beneficiaries, any employee organization representing participants, and contributing employers. The plan sponsor must also inform participants and beneficiaries, any employee organization representing participants, and contributing employers that, if insolvency occurs, benefits will be reduced, but not below the PBGC guarantee level. For any plan year in which a plan is insolvent, the plan sponsor must notify the Secretary, the PBGC, participants and beneficiaries, any employee organization representing participants, and contributing employers of the level of benefits that will be paid for that year.

in the form of unsecured loans to the plan (referred to as financial assistance), regardless of the plan's ability to repay the loan. However, if a plan were later to recover from insolvency status, loans from the PBGC would have to be repaid.

### ***Annual funding notice requirement***

The plan administrator of a multiemployer defined benefit plan must provide an annual funding notice to each participant and beneficiary, each labor organization representing such participants or beneficiaries, each employer obligated to contribute to the plan, and the PBGC.<sup>211</sup> In addition to the other information required to be provided, in the case of a multiemployer plan, the notice must include (1) whether the plan was in critical or endangered status for the plan year, and if so, (2) information on how a person may obtain a copy of the multiemployer plan's funding improvement or rehabilitation plan, as appropriate, and the actuarial and financial data that demonstrate any action taken toward fiscal improvement, and (3) a summary of the funding improvement plan, rehabilitation plan, or modification thereof adopted during the plan year.

### ***PBGC guarantee of multiemployer plan benefits***

The PBGC benefit guarantee level for multiemployer plans is the sum of 100 percent of the first \$11 of vested monthly benefits and 75 percent of the next \$33 of vested monthly benefits, multiplied by the participant's number of years of service. Thus, the guarantee level for a particular participant depends on the participant's years of service. For example, if a participant has 20 years of service under a multiemployer plan, the maximum monthly benefit covered by the guarantee is \$35.75 per month  $[(100\% \times \$11) + (75\% \times \$33)] \times 20 = \$715$ , or a yearly benefit of \$8,580  $(\$715 \times 12)$ .

### ***Withdrawal liability***

An employer that withdraws from a multiemployer plan in a complete or partial withdrawal is generally liable to the plan in the amount determined to be the employer's withdrawal liability.<sup>212</sup> In general, a "complete withdrawal" means the employer has permanently ceased operations under the plan or has permanently ceased to have an obligation to contribute. A "partial withdrawal" generally occurs if, on the last day of a plan year, there is a 70-percent contribution decline for such plan year or there is a partial cessation of the employer's contribution obligation.

When an employer withdraws from a multiemployer plan, the plan sponsor is required to determine the amount of the employer's withdrawal liability, notify the employer of the amount of the withdrawal liability, and collect the amount of the withdrawal liability from the employer. In order to determine an employer's withdrawal liability, a portion of the plan's unfunded vested benefits is first allocated to the employer, generally in proportion to the employer's

<sup>211</sup> ERISA sec. 101(f). Annual funding notice requirements, with some differences, apply also to single-employer and multiple-employer plans.

<sup>212</sup> ERISA secs. 4201–4225. Under ERISA section 4219(d), the prohibited transaction restrictions under ERISA section 406(a) do not apply to any action permitted or required under the withdrawal liability rules.

share of plan contributions for a previous period.<sup>213</sup> The amount of unfunded vested benefits allocable to the employer is then subject to various reductions and adjustments. An employer's withdrawal liability is generally payable, with interest, in level annual installments. However, the amount of the annual installments is limited, based on the amount of the employer's previous contributions to the plan, and the period over which installments are paid is limited to 20 years. An employer's withdrawal is the amount determined after application of these limits. In addition, the plan sponsor and the employer may agree to settle an employer's withdrawal liability obligation for a different amount.

In the case of a multiemployer plan in critical status, the elimination of any prohibited forms of distribution and reductions in adjustable benefits are disregarded in determining a plan's unfunded vested benefits for purposes of determining an employer's withdrawal liability.

### ***ERISA remedies***

ERISA imposes fiduciary responsibility on a plan sponsor and other plan fiduciaries.<sup>214</sup> Under ERISA, a plan participant or beneficiary may bring a civil action in Federal court (1) to recover benefits due him under the terms of the plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan, (2) for appropriate relief in the case of a breach of fiduciary duty, (3) to enjoin any act or practice that violates ERISA or the terms of the plan, or (4) to obtain other appropriate equitable relief to redress a violation of ERISA or the terms of the plan or to enforce any provisions of ERISA or the terms of the plan.<sup>215</sup>

ERISA also allows certain persons adversely affected by an action of the PBGC to bring a civil action in Federal court against the PBGC for appropriate equitable relief (except with respect to withdrawal liability disputes).<sup>216</sup> Persons who may bring an action against the PBGC include a fiduciary, employer, contributing sponsor, member of a contributing sponsor's controlled group, plan participant or beneficiary, or an employee organization representing a plan participant or beneficiary.

### ***Explanation of Provision***

#### ***Suspension of benefits under multiemployer plans in critical and declining status***

##### ***In general***

Under the provision, subject to certain conditions, limitations and procedural requirements, including approval by the Secretary of Treasury as described below, in the case of a multiemployer plan in critical and declining status, notwithstanding the anti-cutback rules, the plan sponsor may amend the plan to suspend benefits that the plan sponsor deems appropriate. In that case, the plan is

<sup>213</sup> Under 29 C.F.R. sec. 4211.2, for this purpose, unfunded vested benefits is the amount by which the value of vested benefits under the plan exceeds the value of plan assets.

<sup>214</sup> ERISA secs. 404 and 409.

<sup>215</sup> ERISA sec. 502.

<sup>216</sup> ERISA sec. 4003(f).

not liable for any benefit payments not made as a result of a suspension of benefits.

For this purpose, a plan is in critical and declining status if the plan (1) otherwise meets one of the definitions of critical status and (2) is projected to become insolvent during the current plan year or any of the 14 succeeding plan years. In applying (2), 19 succeeding plan years is substituted for 14 if either the ratio of inactive plan participants to active plan participants is more than two to one or the plan's funded percentage is less than 80 percent.

In the annual certification of whether a multiemployer plan is in endangered or critical status for a plan year, the plan actuary must also certify whether the plan is or will be in critical and declining status for the plan year. In making a determination with respect to critical and declining status, in addition to the rules generally applicable with respect to status determinations, the plan actuary must (1) if reasonable, assume that each contributing employer in compliance with the multiemployer plan's rehabilitation plan continues to comply through the end of the rehabilitation period (or such later time as may be applicable to the plan) with the terms of the rehabilitation plan that correspond to the applicable schedule of contribution and benefit rates, and (2) take into account any benefit suspensions adopted in a prior plan year that are still in effect.

The provision does not specifically require that the notice of critical status provided to plan participants and beneficiaries, the bargaining parties, the PBGC and the Secretary of Labor include the information that the plan is in critical and declining status. However, the provision amends the information that must be provided in an annual funding notice with respect to a multiemployer plan. The annual funding notice must include (1) whether the plan was in critical and declining status for the plan year and if so, (2) the projected date of insolvency, (3) a clear statement that such insolvency may result in benefit reductions, and (4) a statement describing whether the plan sponsor has taken legally permitted actions to prevent insolvency.

Under the provision, suspension of benefits means the temporary or permanent reduction of any current or future payment obligation of the plan to any plan participant or beneficiary, whether or not the participant or beneficiary is in pay status at the time of the suspension.<sup>217</sup> Any suspension of benefits made under the provision will remain in effect until the earlier of when the plan sponsor provides benefit improvements in accordance with the provision or when the suspension expires by its own terms. Thus, unless the terms of the suspension of benefits provide for the suspension to expire (and for benefits to return to the same level as before the suspension), a suspension of benefits may result in a permanent benefit reduction.

<sup>217</sup> Any references in the provision to suspensions of benefits, increases in benefits, or resump-tions of suspended benefits with respect to participants apply also with respect to benefits of beneficiaries or alternative payees of participants. Under section 414(p)(8) and ERISA section 206(d)(3)(K), an alternate payee is a spouse, former spouse, child or other dependent of a partici-pant who is recognized by a domestic relations order as having a right to receive all, or a portion of, the benefits payable under a plan with respect to the participant.

*Conditions for suspensions*

In addition to the procedural requirements described below, the provision requires two conditions to be met in order for the plan sponsor of a multiemployer plan in critical and declining status for a plan year to suspend benefits:

1. Taking into account the proposed suspensions of benefits (and, if applicable, a proposed partition of the plan under ERISA <sup>218</sup>), the plan actuary certifies that the plan is projected to avoid insolvency, assuming the suspensions of benefits continue until the suspensions expire by their own terms or, if no specific expiration date is set by the terms, indefinitely, and

2. The plan sponsor determines, in a written record to be maintained throughout the period of the suspension of benefits, that, although all reasonable measures to avoid insolvency have been taken (and continue to be taken during the period of the benefit suspensions), the plan is still projected to become insolvent unless benefits are suspended.

In making the determination described above, the plan sponsor may take into account factors including the following:

- current and past contribution levels,
- levels of benefit accruals, including any prior reductions in the rate of benefit accruals,
- prior reductions of adjustable benefits, if any,
- prior suspensions of benefits, if any,
- the impact on plan solvency of the subsidies and ancillary benefits available to active participants,
- compensation levels of active participants relative to employees in the participants' industry generally,
- competitive and other economic factors facing contributing employers,
- the impact of benefit and contribution levels on retaining active participants and bargaining groups under the plan,
- the impact of past and anticipated contribution increases under the plan on employer attrition and retention levels, and
- measures undertaken by the plan sponsor to retain or attract contributing employers.

*Application of and limitations on suspensions*

In general, any suspensions of benefits under the provision are to be equitably distributed across the plan participant and beneficiary population, taking into account factors (with respect to the participants and beneficiaries and their benefits) that may include one or more of the following:

- age and life expectancy,
- length of time in pay status,
- amount of benefit,
- type of benefit, such as survivor, normal retirement, early retirement,
- the extent to which a participant or beneficiary is receiving a subsidized benefit,

<sup>218</sup> ERISA sec. 4233. As discussed in Part B.2., section 122 of the Act amends the partition rules.

- the extent to which a participant or beneficiary has received post-retirement benefit increases,
- any history of benefit increases and reductions,
- the number of years to retirement for active employees,
- any discrepancies between active and retiree benefits,
- the extent to which active participants are reasonably likely to withdraw support for the plan, accelerating employer withdrawals from the plan and increasing the risk of additional benefit reductions for participants in and not in pay status, and
- the extent to which benefits are attributable to service with an employer that failed to pay its full withdrawal liability.

In addition to these factors, any suspensions of benefits under the provision are subject to an aggregate limit and several limits at the individual level. Specifically, in the aggregate (considered, if applicable, in combination with a partition of the plan), any suspensions of benefits must be at the level reasonably estimated to achieve, but not materially exceed, the level that is necessary to avoid insolvency.<sup>219</sup>

At the individual level, no benefits based on disability (as defined under the plan) may be suspended. In addition, the monthly benefit of any participant or beneficiary may not be reduced below 110 percent of the monthly PBGC guarantee level, as determined (as under present law) for that participant or beneficiary.

In the case of a participant or beneficiary who is age 75 or over as of the effective date of the benefit suspension, the amount of the benefit suspension is phased out ratably over the number of months until age 80, with the result that no benefit suspension applies to a participant or beneficiary who, as of the effective date of the benefit suspension, is age 80 or older. Specifically, for a participant or beneficiary who is between age 75 and 80 as of the effective date of the benefit suspension, not more than the applicable percentage of the participant's or beneficiary's maximum suspendable benefits may be suspended. For this purpose, the applicable percentage for a participant or beneficiary is obtained by dividing (1) the number of months during the period beginning with the month after the month containing the effective date of the suspension and ending with the month in which the participant or beneficiary attains the age of 80, by (2) 60 months. Thus, the applicable percentage is determined on the basis of a participant's or beneficiary's age as of the effective date of the benefit suspension and does not change as the participant or beneficiary gets older. A participant's or beneficiary's maximum suspendable benefits is the portion of the participant's or beneficiary's benefits that would otherwise be suspended if the applicable percentage limitation did not apply.<sup>220</sup> For example, if a participant is exactly age 77 (that is, age 77 and zero

<sup>219</sup> If suspensions of benefits under a plan are made in combination with a partition of the plan, the suspensions may not take effect before the effective date of the partition.

<sup>220</sup> The maximum suspendable benefits does not mean a participant's or beneficiary's entire benefit, but only the portion of the benefit that that would otherwise be suspended under the proposed suspensions of benefits, taking into account the other rules applicable to benefit suspensions. For example, in determining the portion of a participant's or beneficiary's benefit that that would otherwise be suspended, the prohibition on reducing benefits below 110 percent of the PBGC guarantee level is taken into account.



months) as of the effective date of the benefit suspension, with a period of 36 months until attainment of age 80, the participant's applicable percentage is 36/60 or 60 percent, and the amount of the suspension of benefits applied to the participant is 60 percent of the portion of the participant's benefits that would otherwise be suspended.

Besides these limitations, an ordering rule applies if benefits under a multiemployer plan include benefits that are directly attributable to a participant's service with an employer that, before the date of enactment of the provision, (1) withdrew from the plan in a complete withdrawal and paid the full amount of its withdrawal liability,<sup>221</sup> and (2) pursuant to a collective bargaining agreement, assumed liability for providing benefits to plan participants and beneficiaries under a separate, single-employer plan sponsored by the employer, in the amount by which those participants' and beneficiaries' benefits under the multiemployer plan are reduced as a result of the financial status of the multiemployer plan.<sup>222</sup> In that case, suspensions of benefits are applied: first, to the maximum extent permissible, to benefits attributable to service with an employer that withdrew from the plan and failed to pay (or is delinquent in paying) the full amount of its withdrawal liability; second, to all other benefits that may be suspended, other than those in the following (third) category; and third, to benefits directly attributable to service with an employer described in the preceding sentence.

#### *Benefit improvements*

The provision contains several requirements with respect to benefit improvements under a multiemployer plan while a suspension of benefits under the plan is in effect. For this purpose, a benefit improvement means a resumption of suspended benefits, an increase in benefits, an increase in the rate at which benefits accrue under the plan, or an increase in the rate at which benefits vest under the plan. Except for resumptions of suspended benefits as discussed below, any limit on benefit improvements while a suspension of benefits is in effect is in addition to any other applicable limits imposed on a plan with respect to benefit increases.

Subject to certain conditions, the plan sponsor may, in its sole discretion, provide benefit improvements while any suspension of benefits remains in effect. However, the plan sponsor may not increase the liabilities of the plan by reason of a benefit improvement for any participant or beneficiary who is not in pay status by the first day of the plan year for which the benefit improvement takes effect (referred to herein as the "benefit improvement year") unless (1) the benefit improvement is accompanied by equitable benefit improvements (as described below) for all participants and beneficiaries who are in pay status before the first day of the benefit improvement year, and (2) the plan actuary certifies that, after

<sup>221</sup> For purposes of the ordering rule, the full amount of an employer's withdrawal liability with respect to a plan is determined under the withdrawal liability rules under ERISA or an agreement with the plan sponsor, whichever is applicable.

<sup>222</sup> The ordering rule does not apply if benefits under a multiemployer plan do not include benefits directly attributable to service with such an employer.

taking any benefit improvements into account, the plan is projected to avoid insolvency indefinitely.

In order to satisfy (1) above, the projected value of the total liabilities attributable to benefit improvements for participants and beneficiaries who are not in pay status by the first day of the benefit improvement year (with this projected value determined as of that day) may not exceed the projected value of the liabilities attributable to benefit improvements for participants and beneficiaries who are in pay status before the first day of the benefit improvement year (with this projected value also determined as of that day). In addition, with respect to the required benefit improvements for participants and beneficiaries who are in pay status before the first day of the benefit improvement year, the plan sponsor must equitably distribute any increase in total liabilities attributable to the benefit improvements to some or all of those participants and beneficiaries, taking into account the factors relevant in equitably distributing benefit suspensions among participants and beneficiaries (as described above) and the extent to which the benefits of the participants and beneficiaries were suspended.

The provision allows benefit improvements only for participants and beneficiaries in pay status. However, a plan sponsor may increase plan liabilities through a resumption of benefits for participants and beneficiaries in pay status only if the plan sponsor equitably distributes the value of resumed benefits to some or all of the participants and beneficiaries in pay status, taking into account the factors relevant in equitably distributing benefit suspensions among participants and beneficiaries (as described above).

Finally, the requirements under the provision with respect to benefit improvements do not apply to a resumption of suspended benefits or a plan amendment that increases liabilities with respect to participants and beneficiaries not in pay status by the first day of the benefit improvement year that (1) the Secretary (in consultation with the PBGC and the Secretary of Labor) determines to be reasonable and that provides for only de minimis increases in plan liabilities, or (2) is required as a condition of qualified retirement plan status under the Code or to comply with other applicable law, as determined by the Secretary.

#### *Effect on withdrawal liability*

Under the provision, suspensions of benefits made under a multi-employer plan in critical and declining status are disregarded in determining the plan's unfunded vested benefits for purposes of determining an employer's withdrawal liability unless the withdrawal occurs more than ten years after the effective date of the benefit suspension.<sup>223</sup>

#### ***Procedural requirements for suspension of benefits***

The provision specifies a series of procedural steps that must be taken and approvals that must be obtained before any proposed suspension of benefits under a multiemployer plan in critical and declining status may be implemented by the plan sponsor. Below

<sup>223</sup> Under the provision, the prohibited transaction restrictions under ERISA section 406(a) do not apply to any arrangement relating to withdrawal liability involving the plan.

is a summary of these procedural steps and approvals. The approval procedures for a proposed suspension of benefits are administered by the Secretary of Treasury (“Treasury”). However, every step of the process requiring action by Treasury is required to be done in consultation with the Pension Benefit Guaranty Corporation (“PBGC”) and the Department of Labor (“DOL”). Thus, all references below to Treasury with respect to these procedures include this required consultation with the PBGC and DOL (including references to information to be provided in required notices).

- Not less than 60 days before submitting an application to Treasury for approval of proposed benefit suspensions, the plan sponsor must appoint a retiree representative if the plan has more than 10,000 participants.
- Plan sponsor submits an application to Treasury for approval of the proposed benefit suspensions. Concurrently with submitting the application, the plan sponsor must provide certain parties (which include plan participants) notice of the application and the proposed benefit suspensions.
- Within 30 days after receipt of the application, Treasury must publish the application on the Treasury Website and publish notice requesting comments on the application in the Federal Register
- Within 225 days after receipt of the application, Treasury must approve or disapprove the application, or the application is deemed to be approved in the absence of an affirmative decision. If the application is denied by Treasury at this step, then the suspension of benefits cannot be implemented and the process does not continue.
- Within 30 days after the approval, if the application is approved, or deemed approved, by Treasury, Treasury must administer a participant and beneficiary vote on the proposed benefit suspension.
- Within 7 days after the vote, unless a majority of participants and beneficiaries vote to reject the proposed benefit suspensions (“negative vote”), Treasury must issue a final authorization to allow implementation of the benefit suspensions.
- Within 14 days after a negative vote, Treasury must determine whether the plan is systemically important. In the event of a negative vote, the benefits suspensions cannot be implemented unless the plan is systemically important.
- Within 90 days after a negative vote with respect to a plan determined to be systemically important, Treasury must issue a final authorization permitting benefit suspensions to be implemented by the plan sponsor and in sufficient time to allow implementation before the end of this 90 day period, but can impose modifications to the proposed suspensions.

#### *Appointment of retiree representative*

If a multiemployer plan has 10,000 or more participants, the plan sponsor is required to appoint a participant of the plan in pay status to act as a retiree representative to advocate for the interests of the retired and deferred vested participants and bene-

ficiaries of the plan throughout the suspension approval process.<sup>224</sup> The appointment must be made no later than 60 days before the plan sponsor submits an application to Treasury for approval of proposed benefit suspensions. The plan is required to provide for reasonable expenses by the retiree representative, including reasonable legal and actuarial support, commensurate with the plan's size and funded status. Duties performed by the retiree representative under this provision are not subject to prohibited transaction rules under the Code and the fiduciary responsibility requirements under ERISA.<sup>225</sup> However, this relief from fiduciary responsibility does not apply to those duties associated with an application to suspend benefits that are performed by a retiree representative who is also a plan trustee.

*Plan sponsor notice of application for Treasury approval of proposed suspension*

The first step in satisfying the procedural requirements for being allowed to implement proposed benefit suspensions (after appointing a retiree representative if applicable) is applying to Treasury for approval of the proposed suspensions, as described below. Concurrently with submitting that application, the plan sponsor must provide a notice to plan participants and beneficiaries, employers with an obligation to contribute to the plan and any employee organization representing participants employed by the employers. The notice must contain the following information:

- sufficient information to enable participants and beneficiaries to understand the effect of any suspensions of benefits, including an individualized estimate (on an annual or monthly basis) of such effect on each participant or beneficiary,
- a description of the factors considered by the plan sponsor in designing the benefit suspensions,
- a statement that the application for approval of any suspension of benefits will be available on the Treasury website and that comments on the application will be accepted,
- information as to the rights and remedies of plan participants and beneficiaries,
- if applicable, a statement describing the appointment of a retiree representative, the date of appointment of the representative, identifying information about the retiree representative (including whether the representative is a plan trustee), and how to contact the representative, and
- information on how to contact Treasury for further information and assistance where appropriate.

The notice must be provided in a form and manner prescribed in guidance by Treasury. It must be written in a manner so as to be understood by the average plan participant. It may be provided in written, electronic, or other appropriate form to the extent such form is reasonably accessible to persons to whom the notice is required to be provided. The notice fulfills the requirement for providing notice of a significant reduction in the future rate of benefit

<sup>224</sup>A deferred vested participant is a participant who has a vested benefit under the plan, is no longer accruing benefits under the plan, and has not yet begun receiving benefits.

<sup>225</sup>Sec. 4975 and ERISA sec. 404(a).

accrual.<sup>226</sup> Treasury is directed to publish a model notice that a plan sponsor may use to meet these requirements.

The provision further specifies that, in addition to providing this notice, it is the sense of the Congress that, depending on the size and resources of the plan and geographic distribution of the plan's participants and beneficiaries, the plan sponsor should take such steps as may be necessary to inform participants and beneficiaries about proposed benefit suspensions through in-person meetings, telephone or internet-based communications, mailed information, or by other means.

*Public notice of the application by Treasury*

The application for approval of the suspension of benefits must be published on the Treasury website. In addition, not later than 30 days after receipt of the application, Treasury must publish a notice in the Federal Register soliciting comments from contributing employers, employee organizations, and participants and beneficiaries of the plan for which an application was made.

*Approval procedures by Treasury*

Under the provision, Treasury must approve the plan sponsor's application for a suspension of benefits upon finding that the plan is eligible for the suspensions and has satisfied the criteria, as previously described, for suspending benefits, limitations on suspensions, and benefit improvements (if any) during suspension and has provided the required notice of the proposed suspensions.

In general, in evaluating an application, Treasury is to accept a plan sponsor's determinations unless Treasury concludes that the plan sponsor's determinations were clearly erroneous. As previously discussed, as a condition for benefit suspensions, the plan sponsor must determine that, although all reasonable measures to avoid insolvency have been taken (and continue to be taken during the period of the benefit suspensions), the plan is still projected to become insolvent unless benefits are suspended. The plan sponsor may take various factors into account in making this determination. In evaluating whether the plan sponsor has met the criteria for its required determination, Treasury must review the plan sponsor's consideration of relevant factors.

Treasury is directed to approve or deny the application within 225 days of the submission by the plan sponsor, and the application for suspension of benefits is deemed approved unless, within such 225 days, Treasury notifies the plan sponsor that it has failed to satisfy one or more of the criteria for approval.

If Treasury rejects a plan sponsor's application, Treasury must provide notice to the plan sponsor detailing the specific reasons for the rejection, including reference to the specific requirement not satisfied.

<sup>226</sup>Section 4980F of the Code and section 204(h) of ERISA require notice of any amendment to significantly reduce the rate of future benefit accrual under a pension plan to be provided to affected plan participants and alternate payees (and employee organizations representing these participants and alternate payees and participating employers) within a reasonable time before the amendment is effective.

*Participant vote to ratify or reject the proposed suspensions*

Not later than 30 days after Treasury approves the proposed benefit suspension, Treasury must administer a vote of plan participants and beneficiaries. No suspension of benefits may take effect pursuant to this provision prior to a vote of the plan participants and beneficiaries with respect to the proposed benefit suspension.

The plan sponsor is required to provide a ballot for the vote (subject to approval by Treasury) that includes the following statements:

- from the plan sponsor in support of the suspension,
- in opposition to the suspension compiled from comments received pursuant to the Notice published in the Federal Register (as described above),
- that the suspension has been approved by Treasury,
- that the plan sponsor has determined that the plan will become insolvent unless the suspension takes effect,
- that insolvency of the plan could result in benefits lower than benefits paid under the suspension, and
- that insolvency of the PBGC would result in benefits lower than benefits paid in the case of plan insolvency.

A negative vote occurs only if a majority of all plan participants and beneficiaries vote to reject the proposed benefit suspensions (“negative vote”).<sup>227</sup> The suspension goes into effect following the vote if the result is not a negative vote. In that case, not later than seven days after the vote, Treasury must issue a final authorization of the suspension.

If the result is a negative vote, the plan sponsor may not implement the benefit suspension unless the plan is systemically important. However, after a negative vote with respect to a plan that is not systemically important, the plan sponsor may start the process again by developing different proposed benefit suspensions, subject to the conditions applicable under the provision, and submitting a new application for approval to Treasury.

*Systemically important plan*

Not later than 14 days after a negative vote, Treasury must determine whether the plan is a systemically important plan. A systemically important plan is a plan with respect to which the PBGC projects that, if suspensions are not implemented, the present value of projected financial assistance payments exceeds \$1 billion (indexed).<sup>228</sup> Not later than 30 days after a determination by Treasury that the plan is systemically important, if applicable, the Participant and Plan Sponsor Advocate (“Advocate”)<sup>229</sup> may submit recommendations to Treasury with respect to the proposed benefit suspensions or any revisions to the proposed suspensions.

<sup>227</sup> Thus, a participant’s or beneficiary’s failure to vote has the effect of a vote in favor of the benefit suspension.

<sup>228</sup> This determination is expected to be made using the assumptions that PBGC generally uses in evaluating the financial position of its multiemployer program. For calendar years beginning after 2015, the \$1 billion is indexed by reference to the change in the wage base applicable for purposes of Social Security taxes and benefits since 2014. If the amount otherwise determined under this calculation is not a multiple of \$1 million, the amount is rounded to the next lowest multiple of \$1 million.

<sup>229</sup> The Advocate is selected under section 4004 of ERISA.

If Treasury determines that the plan is a systemically important plan, not later than the end of the 90-day period beginning on the date the results of the vote are certified, Treasury must, notwithstanding the negative vote, issue a final authorization either:

- permitting the implementation of the benefit suspensions proposed by the plan sponsor; or
- permitting the implementation of a modification by Treasury of the benefit suspensions (giving consideration to any recommendations submitted by the Advocate), provided that the plan is projected to avoid insolvency under the modification.

However, the provision also requires that Treasury issue the final authorization at a time sufficient to allow implementation of the benefit suspension before the end of the 90-day period. Thus, the deadline for issuance of the final authorization of the suspension is actually earlier than the end of the 90-day period.

### ***Appeal of decisions***

For purposes of judicial review of agency action, approval or denial by Treasury of an application is treated as a final agency action.<sup>230</sup>

An action by a plan sponsor challenging the denial of an application for suspension of benefits by Treasury may only be brought following the denial. An action challenging a suspension of benefits may only be brought following a final authorization to suspend by Treasury. A participant or beneficiary affected by a benefit suspension does not have a cause of action under the Code or Title I of ERISA.<sup>231</sup> No action challenging a suspension of benefits following the final authorization to suspend or the denial of an application for suspension of benefits may be brought after one year after the earliest date on which the plaintiff acquired or should have acquired actual knowledge of the existence of the cause of action.

A court review of an action challenging a suspension of benefits is to be done in accordance with the rules for judicial review of agency actions.<sup>232</sup> A court reviewing an action challenging a suspension of benefits may not grant a temporary injunction with respect to the suspension unless the court finds a clear and convincing likelihood that the plaintiff will prevail on the merits of the case.

<sup>230</sup> Rules for judicial review of agency action are provided at 5 U.S.C. chap. 7 (part of the Administrative Procedure Act). The provision does not specifically make these rules applicable to Treasury's approval or denial of an application for benefit suspensions. However, under 5 U.S.C. sec. 701, these rules apply except to the extent that statutes preclude judicial review or agency action is committed to agency discretion by law. Pursuant to 5 U.S.C. sec. 704, agency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review under these rules.

<sup>231</sup> A participant or beneficiary might otherwise have a cause of action against the plan sponsor under ERISA section 502 with respect to the benefit suspension.

<sup>232</sup> In reviewing an agency action, under 5 U.S.C. sec. 706, the reviewing court is to decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court is to set aside agency action in certain circumstances, such as when found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. In making its determinations, the court is to review the whole record, or those parts of it cited by a party, and due account is to be taken of the rule of prejudicial error.

Under the provision, a plan sponsor is added to the list of persons who may bring action against the PBGC for appropriate equitable relief in Federal court.<sup>233</sup>

### ***Guidance***

The Secretary of the Treasury, in consultation with the PBGC and the Secretary of Labor, is directed to publish, not later than 180 days after enactment, appropriate guidance to implement the provision.

### ***Effective Date***

The provision is effective on the date of enactment (December 16, 2014).

## **DIVISION P—OTHER RETIREMENT-RELATED MODIFICATIONS**

### **A. Substantial Cessation of Operations (sec. 1 of the Act and sec. 4062(e) of ERISA)**

#### ***Present Law***

#### ***Funding rules for single-employer defined benefit plans and PBGC insurance program***

Employer contributions to private defined benefit plans are generally subject to minimum funding requirements under the Code and ERISA.<sup>234</sup> Unless a funding waiver is obtained from the Secretary of the Treasury (“Secretary”), an employer may be subject to a two-tier excise tax if the funding requirements are not met.<sup>235</sup>

The minimum required contribution for a plan year for a single-employer defined benefit plan generally depends on a comparison of the value of the plan’s assets, reduced by any prefunding balance or funding standard carryover balance (“net value of plan assets”),<sup>236</sup> with the plan’s funding target and target normal cost. The plan’s funding target for a plan year is the present value of all benefits accrued or earned as of the beginning of the plan year. A plan’s target normal cost for a plan year is generally the present value of benefits expected to accrue or to be earned during the plan year.

If the net value of plan assets is less than the plan’s funding target, so that the plan has a funding shortfall (discussed further below), the minimum required contribution is the sum of the plan’s target normal cost and the shortfall amortization charge for the plan year (determined as described below).<sup>237</sup> If the net value of

<sup>233</sup>As under present law, this right to bring an action does not apply with respect to withdrawal liability disputes.

<sup>234</sup>Secs. 412 and 430–433 and ERISA secs. 301–306.

<sup>235</sup>Sec. 4971.

<sup>236</sup>The value of plan assets is generally reduced by any prefunding balance or funding standard carryover balance in determining minimum required contributions. A prefunding balance results from plan contributions that exceed the minimum required contributions. A funding standard carryover balance results from a positive balance in the funding standard account that applied under the funding requirements in effect before PPA. Subject to certain conditions, a prefunding balance or funding standard carryover balance may be credited against the minimum required contribution for a year, reducing the amount that must be contributed.

<sup>237</sup>If the plan has obtained a waiver of the minimum required contribution (a funding waiver) within the past five years, the minimum required contribution also includes the related waiver



plan assets is equal to or exceeds the plan's funding target, the minimum required contribution is the plan's target normal cost, reduced by the amount, if any, by which the net value of plan assets exceeds the plan's funding target.

Restrictions on benefit increases, certain types of benefits and benefit accruals (collectively referred to as benefit restrictions) may apply to a plan if the plan is funded below a certain level.<sup>238</sup> In some cases, an employer may make an additional plan contribution to avoid a benefit restriction. In such a case, the additional contribution does not result in a prefunding balance.

The Pension Benefit Guaranty Corporation ("PBGC") provides a mandatory insurance program for benefits under most defined benefit plans maintained by private employers. If the assets of a single-employer plan are not sufficient to pay benefits due under the plan and the plan terminates in a distress termination (for example, in a bankruptcy proceeding of the employer maintaining the plan), the plan becomes the responsibility of the PBGC. The PBGC becomes the trustee of the plan, takes control of any plan assets, and assumes responsibility for benefits that cannot be provided from plan assets, subject to certain limits.

### ***Substantial cessation of operations***

Certain additional funding-related requirements apply if a substantial cessation of operations occurs in connection with a single-employer defined benefit plan.<sup>239</sup> For this purpose, a substantial cessation of operations occurs if the employer maintaining the plan ceases operations at a facility, for example, closes a plant, and, as a result, more than 20 percent of the total active participants in the plan are separated from employment.

If a substantial cessation of operations occurs, the employer is required to notify the PBGC and pay to the PBGC a portion of the unfunded benefit liabilities under the plan (determined in the same manner as if the plan were terminating), which the PBGC then holds in escrow. Alternatively, the employer can provide a bond for 150 percent of the amount it would otherwise have to pay to the PBGC.

The escrow or bond is released after five years if the defined benefit plan is not terminated during that time. If the plan is terminated within five years, the escrow or bond proceeds are used to fund the plan as needed to pay all benefits due under the plan, with any remaining amounts returned to the employer.

The PBGC also has authority to enter into an alternative arrangement with an employer on a voluntary basis, rather than requiring the payment to the PBGC or the bond.

On July 8, 2014, the PBGC announced a moratorium, until December 31, 2014, on enforcement action with respect to substantial cessations of operations.<sup>240</sup>

amortization charge, that is, the annual installment needed to amortize the waived amount in level installments over the five years following the year of the waiver.

<sup>238</sup> Sec. 436 and ERISA sec. 206(g).

<sup>239</sup> ERISA sec. 4062(e), under which the rules of ERISA section 4063 (which generally deal with the withdrawal of an employer from a multiple-employer plan) apply.

<sup>240</sup> PBGC Issues Moratorium on 4062(e) Enforcement, available at <http://www.pbtc.gov/news/press/releases/pr14-09.html>.

### ***Explanation of Provision***

#### ***In general***

The provision amends the rules relating to a substantial cessation of operations by providing a new definition of a substantial cessation of operations, exceptions to the application of the substantial cessation of operations requirements, and an alternative method for an employer to satisfy its liability with respect to a substantial cessation of operations.<sup>241</sup>

Under the provision, a substantial cessation of operations means a permanent cessation of an employer's operations at a facility that results in a workforce reduction of a number of eligible employees at the facility that is more than 15 percent of the number of all of the employer's eligible employees. For this purpose, an eligible employee is any employee who is eligible to participate in a defined benefit or a defined contribution plan established and maintained by the employer. Thus, whether a substantial cessation of operations has occurred is not determined only by reference to the active participants in the defined benefit plan affected by the cessation.

For purposes of whether a substantial cessation of operations has occurred, the number of all of the employer's eligible employees is generally determined immediately before the date of the employer's decision to implement the cessation of operations. However, under a special rule, previous employees previously separated from employment may be required to be taken into account. That is, the workforce reduction with respect to a cessation of operations is determined by taking into account the separation from employment of any eligible employee at the facility that is related to the permanent cessation of the employer's operations at the facility and occurs during the 3-year period preceding the cessation. In that case, the number of all of the employer's eligible employees is determined immediately before the earliest date on which any of the eligible employees was separated from employment.

In general, a workforce reduction at a facility means the number of eligible employees at the facility who are separated from employment by reason of the permanent cessation of operations at the facility. However, in the case of relocation of a workforce or disposition of a facility, certain eligible employees separated from employment at a facility ("separated employees") are not taken into account in computing a workforce reduction.

A separated employee is not taken into account in computing a workforce reduction in the case of a relocation of a workforce if, within a reasonable period of time, the employer replaces the employee, at the same or another facility located in the United States, with an employee who is a citizen or resident of the United States.

In addition, a separated employee is not taken into account in computing a workforce reduction in the case of certain dispositions related to operation of a facility. If an employer ("transferee em-

<sup>241</sup>Sec. 109 of Division G of the Act provides that none of the funds made available by the Act may be used by the PBGC to take any action in connection with any asserted liability under ERISA section 4062(e), provided that section 109 ceases to apply on the enactment of any bill that amends section 4062(e). Thus, section 109 ceases to apply as a result of enactment of the provision.

ployer”), other than the employer that maintains a plan in connection with operations at a facility and experiences the substantial cessation of operations (“transferor employer”), conducts any portion of the operations (whether by reason of a sale or other disposition of the assets or stock of the transferor employer, or any member of the same controlled group), then a separated employee is not taken into account if, within a reasonable period of time, (1) the transferee employer replaces the employee with an employee who is a citizen or resident of the United States, and (2) in the case of a separated employee who is a participant in a single-employer plan maintained by the transferor employer, the transferee employer maintains a single-employer plan that includes the assets and liabilities attributable to the accrued benefit of the separated employee at the time of separation from employment with the transferor employer. In the case of a separated employee who continues to be employed at the facility by the transferee employer, the employee is not taken into account in computing a workforce reduction if (1) the employee is not a participant in a single-employer plan maintained by the transferor employer, or (2) within a reasonable period of time, the transferee employer maintains a single-employer plan that includes the assets and liabilities attributable to the accrued benefit of the employee at the time of separation from employment with the transferor employer.

### ***Exceptions***

Under the provision, the substantial cessation of operations rules do not apply with respect to a defined benefit plan if, for the plan year preceding the plan year in which the cessation occurs, (1) there were fewer than 100 participants with accrued benefits under the plan, or (2) the ratio of the fair market value of the plan’s assets to the plan’s funding target was 90 percent or greater.

In addition, an employer is not treated as ceasing operations at a qualified lodging facility if the operations are continued by an eligible independent contractor pursuant to an agreement with the employer. For this purpose, the terms qualified lodging facility and eligible independent contractor are defined by reference to the real estate investment trust (“REIT”) rules under the Code.<sup>242</sup>

### ***Alternative of additional contributions to satisfy liability***

#### ***In general***

The provision allows an employer to elect to satisfy its liability with respect to a substantial cessation of operations by making certain additional contributions to the defined benefit plan for the seven plan years beginning with the plan year in which the cessation occurs. The additional contribution for any plan year is in

<sup>242</sup>Sec. 856(d)(9)(D) and (A), respectively. A qualified lodging facility is generally any lodging facility (such as a hotel or motel) unless wagering activities are conducted at or in connection with the facility by any person engaged in the business of accepting wagers and legally authorized to engage in that business at or in connection with the facility. An independent contractor with respect to a qualified lodging facility means any independent contractor if, at the time the contractor enters into a management agreement or other similar service contract with a taxable REIT subsidiary to operate the qualified lodging facility, the contractor (or any related person) is actively engaged in the trade or business of operating qualified lodging facilities for a person who is not a related person with respect to the taxable REIT subsidiary or the REIT of which it is a subsidiary.

addition to any minimum required contribution under the funding rules and, like additional contributions made to avoid a benefit restriction, does not result in a prefunding balance. Any additional contribution for a year must be paid by the earlier of (1) the due date for the minimum required contribution for the year, or (2) in the case of the first contribution, one year after the date the employer notifies the PBGC of the substantial cessation of operations or the date the PBGC determines a substantial cessation of operations has occurred, and in the case of subsequent contributions, the same date in each succeeding year.

Subject to the limit described below, the amount of an additional contribution is (1) one-seventh of the amount of the unfunded vested benefits under the plan, as determined for the plan year preceding the plan year in which the cessation occurred, multiplied by (2) the reduction fraction. Unfunded vested benefits under a plan is the amount by which the present value of all vested benefits accrued or earned as of the beginning of the plan year exceeds the fair market value of the plan's assets for the year. The reduction fraction is (1) the number of participants with accrued benefits under the plan who were taken into account in computing the workforce reduction resulting from the cessation of operations, divided by (2) the number of eligible employees with accrued benefits in the plan (determined as of the same date used in determining the number of all of the employer's eligible employees for purposes of whether a substantial cessation of operations occurred).

The additional contribution for any plan year is limited to the excess, if any, of (1) 25 percent of the difference between the fair market value of the plan's assets and the plan's funding target for the preceding plan year, over (2) the minimum required contribution for the plan year, determined without regard to the additional contribution. In addition, an employer's obligation to make additional contributions does not apply to the first plan year (beginning on or after the first day of the plan year in which the cessation occurs) for which the ratio of the fair market value of the plan's assets to the plan's funding target is 90 percent or greater or any subsequent year.

If the Secretary issues a funding waiver with respect to the plan for any plan year for which an additional contribution is due, the additional contribution for that plan year is permanently waived. If a funding waiver has been issued with respect to a plan or a request for a funding waiver is pending, the employer maintaining the plan is required to provide notice to the Secretary of the substantial cessation of operations in the form and at the time as provided by the Secretary.

#### *Enforcement*

An employer electing to make additional contributions must provide notice to the PBGC, in accordance with rules prescribed by the PBGC, of—

- the election, not later than 30 days after the earlier of the date the employer notifies the PBGC of the substantial cessation of operations or the date the PBGC determines a substantial cessation of operations has occurred,

- the payment of each additional contribution, not later than 10 days after the payment,
- any failure to pay an additional contribution in the full amount for any of the seven years for which additional payments are due, not later than 10 days after the due date for such payment,
- any funding waiver that waives the obligation to make an additional contribution for any year, not later than 30 days after the funding waiver is granted, and
- the cessation of any obligation to make additional contributions because the ratio of the fair market value of the plan's assets to the plan's funding target is 90 percent or greater, not later than 10 days after the due date for payment of the additional contribution for the first plan year to which such cessation applies.

If an employer fails to pay an additional contribution for any year in the full amount by the due date for the payment, as of that date, the employer is liable to the plan for the remaining unpaid balance of the aggregate additional contributions required for the seven plan years. The PBGC may waive or settle this liability at its discretion. The PBGC may also bring a civil action in Federal district courts to compel an employer that elects to make additional contributions to pay the additional contributions required.

### ***Effective Date***

The provision is generally effective for a cessation of operations or other event at a facility occurring on or after the date of enactment (December 16, 2014).

Under a transition rule, an employer that had a cessation of operations before the date of enactment (as determined under the substantial cessation of operations rules in effect before the date of enactment), but did not, before the date of enactment, enter into an arrangement with the PBGC to satisfy the requirements of those rules, may elect to make additional contributions under the provision to satisfy its liability as if the cessation occurred on the date of enactment. The election must be made not later than 30 days after the PBGC issues, on or after the date of enactment, a final administrative determination that a substantial cessation of operations has occurred.

In addition, the PBGC must not take any enforcement, administrative, or other action with respect to a substantial cessation of operations, or in connection with an agreement settling liability arising with respect to a substantial cessation of operations, that is inconsistent with the amendments made by the provision, regardless of whether the action relates to a cessation or other event that occurs before, on, or after the date of enactment, unless the action is in connection with a settlement agreement in place before June 1, 2014. The PBGC also must not initiate a new enforcement action with respect to a substantial cessation of operations that is inconsistent with its enforcement policy in effect on June 1, 2014.

**B. Clarification of the Normal Retirement Age (sec. 2 of the Act, sec. 411 of the Code, and sec. 204 of ERISA)**

***Present Law***

***Rules relating to normal retirement age***

Normal retirement age is relevant for various purposes under the requirements relating to qualified defined benefit plans.<sup>243</sup> Normal retirement age is generally the age specified for normal retirement under the plan, but may not be later than age 65 or, if later, the fifth anniversary of the time a participant commences participation in the plan.<sup>244</sup>

Under the vesting rules, a participant's right to employer-provided benefits he or she has earned or "accrued" under a plan ("accrued benefit") generally must become nonforfeitable after a specified period of service. In addition, a participant's right to the benefit under the plan commencing at normal retirement age (the "normal retirement benefit") must become nonforfeitable on attainment of normal retirement age. In the case of a defined benefit plan, a participant's accrued benefit at any given time is generally the portion of the normal retirement benefit that the participant has earned as of that time. That is, if a participant terminates employment before reaching normal retirement age, the benefit to which the participant is entitled to receive on reaching normal retirement age is the accrued benefit.

Under the accrual rules (also referred to as the "anti-backloading" rules), the pattern in which a participant's normal retirement benefit is earned over his or her period of service to normal retirement age must satisfy one of three options ("accrual methods").<sup>245</sup> This serves as a backstop to the vesting rules by requiring a participant's normal retirement benefit to be earned relatively smoothly over his or her service, rather than having a disproportionate amount earned only at a later age or completion of longer service (that is, "backloaded").

A defined benefit plan is permitted to provide a wide variety of optional forms of distribution with respect to the accrued benefit, but each form must be at least the actuarial equivalent of the accrued benefit.<sup>246</sup> A defined benefit plan may provide for a subsidized early retirement benefit or other retirement-type subsidies, the right to which is not required to vest or accrue in accordance with the vesting and accrual requirements. For example, a plan with a normal retirement age of 65 might provide for payment of a participant's accrued benefit on retirement at age 55 without actuarial reduction for early commencement, but conditioned on the participant having at least 30 years of service.

Defined benefit plans generally may not provide for distributions to a participant during employment (referred to as "in-service" dis-

<sup>243</sup> See, for example, the vesting and accrual requirements under sections 401(a)(7) and 411. Similar requirements apply under sections 203 and 204 of the Employee Retirement Income Security Act of 1974 ("ERISA"). These requirements (and ERISA) generally do not apply to governmental plans or church plans.

<sup>244</sup> Sec. 411(a)(8) of the Code and sec. 3(24) of ERISA.

<sup>245</sup> Sec. 411(b) of the Code and sec. 204 of ERISA.

<sup>246</sup> The assumptions for determining actuarial equivalence (interest rate and mortality) must be specified in the plan in a manner that precludes employer discretion. In the case of certain forms of benefit, including lump sums, specific actuarial assumptions must be used.

tributions) unless the participant has attained normal retirement age (or age 62, if earlier) or in the case of plan termination.<sup>247</sup> Under final Treasury regulations issued in 2007, the normal retirement age under a plan must be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.<sup>248</sup> Under the regulations, a normal retirement age of age 62 or later is deemed not to be earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.

### ***Normal retirement ages with a service component***

Some defined benefit plans have defined normal retirement age as the earlier of a fixed age (such as age 62) or the completion of a specified period of service (for example, 30 years) and have permitted participants to receive in-service distributions of their full normal retirement benefits (that is, without an actuarial reduction for early commencement) after completion of the period of service.

The IRS has indicated that a plan under which a participant's normal retirement age changes to an earlier date upon completion of a stated number of years of service typically will not satisfy the vesting and accrual rules.<sup>249</sup> An unreduced early retirement benefit is permitted to be conditioned on completion of a stated number of years of service (such as 30 years of service); however, an early retirement benefit is generally permitted to be paid only after termination of employment.

### ***Nondiscrimination requirements***

Qualified retirement plans may not discriminate in favor of highly compensated employees with respect to contributions or benefits.<sup>250</sup> In the case of a defined benefit plan, whether benefits are discriminatory is generally based on the benefits provided at a uniform normal retirement age.<sup>251</sup>

### ***Explanation of Provision***

Under the provision, a defined benefit plan meeting certain requirements (an "applicable" plan) is not treated as failing any qualification requirement or any requirement under ERISA, or as failing to have a uniform normal retirement age for these purposes, solely because the plan provides a normal retirement age of the earlier of (1) an age otherwise permitted under the definition of normal retirement age in the Code and ERISA, or (2) the age at which a participant completes the number of years (not less than 30) of service specified by the plan. An applicable plan is a defined benefit plan the terms of which, on or before December 8, 2014, provided for such a normal retirement age. A plan is generally an applicable plan only with respect to an individual who (1) is a par-

<sup>247</sup> Sec. 401(a)(36); Treas. Reg. secs. 1.401-1(b)(1)(i) and 1.401(a)-1(b)(1)(i).

<sup>248</sup> Treas. Reg. sec. 1.401(a)-1(b)(2). These regulations apply to all qualified defined benefit plans, including governmental plans and church plans.

<sup>249</sup> Notice 2007-69, 2007-2 C.B. 468.

<sup>250</sup> Sec. 401(a)(4). For this purpose, highly compensated employees are generally five-percent owners and employees with compensation above a certain level for the preceding year. For 2014, the compensation level is \$115,000.

<sup>251</sup> Treas. Reg. secs. 1.401(a)(4)-3 and -12.

participant in the plan on or before January 1, 2017, or (2) is an employee at any time on or before January 1, 2017, of any employer maintaining the plan and who becomes a participant in the plan after January 1, 2017.

A plan does not fail to be an applicable plan solely because, as of December 8, 2014, the normal retirement age described above applied only to certain plan participants or, in the case of a plan maintained by more than one employer, only to employees of certain employers. In addition, subject to the limitation described above relating to participation or employment on or before January 1, 2017, if application of this normal retirement age is expanded after December 8, 2014, to additional participants or employees of additional employers, the plan will be treated as an applicable plan with respect to those participants and employees.

### ***Effective Date***

The provision applies to all periods before, on, and after the date of enactment (December 16, 2014).

### **C. Application of Cooperative and Small Employer Charity Pension Plan Rules to Certain Charitable Employers Whose Primary Exempt Purpose is Providing Services with Respect to Children (sec. 3 of the Act, sec. 414(y) of the Code, and sec. 210(f) of ERISA)**

#### ***Present Law***

Defined benefit plans maintained by private employers are generally subject to minimum funding requirements.<sup>252</sup> Different minimum funding rules apply to (1) single-employer plans and most multiple-employer plans, (2) multiple-employer plans that are CSEC (cooperative and small employer charity) plans, and (3) multiemployer plans.<sup>253</sup> For this purpose, businesses and organizations that are members of a controlled group, a group under common control, or an affiliated service group are treated as one employer (referred to as “aggregation”).<sup>254</sup>

Funding rules for CSEC plans were enacted by the Cooperative and Small Employer Charity Pension Flexibility Act.<sup>255</sup> For this purpose, a CSEC plan is a defined benefit plan (other than a multiemployer plan) (1) that is an eligible cooperative plan to which a delayed effective date for funding rules enacted under the Pension Protection Act of 2006 (“PPA”) applies (without regard to the January 1, 2017, end of the delayed effective date),<sup>256</sup> or (2) that, as of June 25, 2010, was maintained by more than one employer (taking into account the aggregation rules for controlled groups and groups

<sup>252</sup> Secs. 412 and 430–433 and ERISA secs. 301–306. Unless a funding waiver is obtained, an employer may be subject to a two-tier excise tax under section 4971 if the funding requirements are not met.

<sup>253</sup> See Part Six and Part Nine, Division O, above, for descriptions of these plans and the funding rules applicable to each type.

<sup>254</sup> Secs. 414(b), (c), (m) and (o).

<sup>255</sup> Pub. L. No. 113 197, discussed in Part Six.

<sup>256</sup> This delayed effective date is provided under section 104 of PPA, Pub. L. No. 109–280.



under common control) and all of the employers were tax-exempt charitable organizations.<sup>257</sup>

### ***Explanation of Provision***

The provision amends the definition of CSEC plan to include a plan that, as of June 25, 2010, was maintained by an employer (1) that is a tax-exempt charitable organization and a Federally-chartered patriotic organization,<sup>258</sup> (2) that has employees in at least 40 States, and (3) the primary exempt purpose of which is to provide services with respect to children. For purposes of determining the employer maintaining the plan, the aggregation rules for controlled groups and groups under common control employers apply.

### ***Effective Date***

The provision is effective as if included in the Cooperative and Small Employer Charity Pension Flexibility Act. As a result, the provision is effective for plan years beginning after December 31, 2013.

---

<sup>257</sup> June 25, 2010 is the date of enactment of the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 ("PRA 2010"), Pub. L. No. 111–192, which expanded the applicability of the delayed effective date. A tax-exempt charitable organization is an organization exempt from tax under section 501(c)(3).

<sup>258</sup> A Federally-chartered patriotic organization is an organization chartered under part B of subtitle II of title 36, United States Code.

**PART TEN: AN ACT TO AMEND CERTAIN PROVISIONS OF  
THE FAA MODERNIZATION AND REFORM ACT OF 2012  
(PUBLIC LAW 113–243)<sup>259</sup>**

**A. Rollover of Amounts Received in Airline Carrier Bankruptcy (sec. 1 of the Act and sec. 1106 of the FAA Modernization and Reform Act of 2012)**

*Present Law*

*Individual retirement arrangements*

The Code provides for two types of individual retirement arrangements (“IRAs”): traditional IRAs and Roth IRAs.<sup>260</sup>

Contributions to a traditional IRA may be deductible from gross income, or nondeductible contributions may be made, which result in “basis.” Distributions from a traditional IRA are includible in gross income to the extent not treated as a return of basis (that is, if attributable to deductible contributions or earnings).

Contributions to a Roth IRA are not deductible (and result in basis), and qualified distributions from a Roth IRA are excludable from gross income. Distributions from a Roth IRA that are not qualified distributions are includible in gross income to the extent not treated as a return of basis (that is, if attributable to earnings). In general, a qualified distribution from a Roth IRA is a distribution that (1) is made after the five taxable year period beginning with the first taxable year for which the individual first made a contribution to a Roth IRA, and (2) is made on or after the individual attains age 59½, death, or disability or which is a qualified special purpose distribution.

The total amount that an individual may contribute to one or more IRAs for a year (other than a rollover contribution, discussed below) is generally limited to the lesser of: (1) a dollar amount (\$5,500 for 2014); or (2) the amount of the individual’s compensation that is includible in gross income for the year.<sup>261</sup> In the case of married individuals filing a joint return, a contribution up to the dollar limit for each spouse may be made, provided the combined compensation of the spouses is at least equal to the contributed amount.

Subject to certain requirements, an individual may roll a distribution from an IRA over to an IRA of the same type on a non-taxable basis (that is, without income inclusion). In addition, an individual generally may convert a traditional IRA to a Roth IRA. In

<sup>259</sup>H.R. 2591. The House passed H.R. 2591 on December 11, 2014. The Senate passed the bill without amendment on December 13, 2014. The President signed the bill on December 18, 2014.

<sup>260</sup>Traditional IRAs are described in section 408, and Roth IRAs are described in section 408A.

<sup>261</sup>The maximum contribution amount is increased by \$1,000 for individuals 50 years of age or older.

that case, the amount converted is includible in income as if a distribution from the traditional IRA had been made.

***Rollover of airline payments to traditional IRAs***

Under the FAA Modernization and Reform Act of 2012 (“2012 FAA Act”), if a qualified airline employee contributes any portion of an airline payment amount to a traditional IRA within 180 days of receipt of the amount (or, if later, within 180 days of February 14, 2012, the date of enactment of the 2012 FAA Act), the amount contributed is treated as a rollover contribution to the IRA.<sup>262</sup> A qualified airline employee making such a rollover contribution may exclude the contributed amount from gross income for the taxable year in which the airline payment amount was paid to the qualified airline employee.

For this purpose, a qualified airline employee is an employee or former employee of a commercial passenger airline carrier who was a participant in a qualified defined benefit plan maintained by the carrier that was terminated or that became subject to the benefit accrual and other restrictions applicable to certain plans under the Pension Protection Act of 2006 (“PPA”).<sup>263</sup> If a qualified airline employee dies after receiving an airline payment amount, or if an airline payment amount is paid to a surviving spouse of a qualified airline employee, the surviving spouse may receive the same rollover contribution treatment (and the related exclusion from income) as the employee could have received.

An airline payment amount is any payment of any money or other property payable by a commercial passenger airline to a qualified airline employee: (1) under the approval of an order of a Federal bankruptcy court in a case filed after September 11, 2001, and before January 1, 2007, and (2) in respect of the qualified airline employee’s interest in a bankruptcy claim against the airline carrier, any note of the carrier (or amount paid in lieu of a note being issued), or any other fixed obligation of the carrier to pay a lump sum amount. An airline payment amount does not include any amount payable on the basis of the carrier’s future earnings or profits. The amount of any airline payment amount is determined without regard to the withholding of the employee’s share of taxes under the Federal Insurance Contributions Act (“FICA”) or income tax.<sup>264</sup> Thus, for purposes of the rollover provision and the related exclusion from income, the gross amount of the airline payment amount (before withholding) applies.

The ability to contribute airline payment amounts to a traditional IRA as a rollover contribution (and the related exclusion

<sup>262</sup> Sec. 1106 of Pub. L. No. 112–95. Under section 125 of the Worker, Retiree, and Employer Recovery Act of 2008 (“WRERA”), Pub. L. No. 110–458, a qualified airline employee is permitted to contribute any portion of an airline payment amount to a Roth IRA within 180 days of receipt of such amount (or, if later, within 180 days of December 23, 2008, the date of enactment of WRERA), and the amount contributed is treated as a rollover contribution to the Roth IRA. The 2012 FAA Act permitted an employee who had previously made a rollover contribution of an airline payment amount to a Roth IRA to recharacterize all or a portion of the rollover contribution as a rollover contribution to a traditional IRA and to exclude the recharacterized amount from income.

<sup>263</sup> Pub. L. No. 109–280. Section 402 of PPA provides funding relief with respect to certain defined benefit plans maintained by commercial passenger airlines, subject to meeting the benefit accrual and other restrictions under PPA section 402(b)(2) and (3).

<sup>264</sup> Secs. 3102 and 3402. An airline payment amount that is excluded from income under the 2012 FAA Act continues to be wages for FICA and Social Security earnings purposes.

from income) is subject to limitations. First, a qualified airline employee is not permitted to contribute an airline payment amount to a traditional IRA for a taxable year if, at any time during the taxable year or a preceding taxable year, the employee was a “covered employee,” that is, the principal executive officer (or an individual acting in such capacity) within the meaning of the Securities Exchange Act of 1934 or among the three most highly compensated officers for the taxable year (other than the principal executive officer), of the commercial passenger airline carrier making the airline payment amount.<sup>265</sup> Second, in the case of a qualified airline employee who was not at any time a covered employee, the amount that may be contributed to a traditional IRA for a taxable year cannot exceed the excess (if any) of (1) 90 percent of the aggregate airline payment amounts received during the taxable year and all preceding taxable years, over (2) the aggregate amount contributed to a traditional IRA (and excluded from income) for all preceding taxable years (“90 percent limitation”).

Under the 2012 FAA Act, a qualified airline employee who excludes from income an airline payment amount contributed to a traditional IRA may file a claim for a refund until the later of: (1) the usual period of limitation (generally, three years from the time the return was filed or two years from the time the tax was paid, whichever period expires later),<sup>266</sup> or (2) April 15, 2013.

### ***Explanation of Provision***

The provision amends the definition of qualified airline employee under the 2012 FAA Act to include an employee or former employee of a commercial passenger airline carrier who was a participant in a qualified defined benefit plan maintained by the carrier that was frozen (that is, under which all benefit accruals ceased) as of November 1, 2012. The provision also amends the definition of airline payment amount under the 2012 FAA Act to include any payment of any money or other property payable by a commercial passenger airline (but not any amount payable on the basis of the carrier’s future earnings or profits) to a qualified airline employee: (1) under the approval of an order of a Federal bankruptcy court in a case filed on November 29, 2011, and (2) in respect of the qualified airline employee’s interest in a bankruptcy claim against the airline carrier, any note of the carrier (or amount paid in lieu of a note being issued), or any other fixed obligation of the carrier to pay a lump sum amount. Thus, as a result of the provision, if a qualified airline employee (other than a covered employee as described above) under a qualified defined benefit plan that was fro-

<sup>265</sup> Covered employee status is defined by reference to section 162(m) (limiting deductions for compensation of covered employees), which defines a covered employee as (1) the chief executive officer of the corporation (or an individual acting in such capacity) as of the close of the taxable year, and (2) the four most highly compensated officers for the taxable year (other than the chief executive officer), whose compensation is required to be reported to shareholders under the Securities Exchange Act of 1934. Treas. Reg. sec. 1.162-27(c)(2) provides that whether an employee is the chief executive officer or among the four most highly compensated officers is determined pursuant to the executive compensation disclosure rules promulgated under the Securities Exchange Act of 1934. To reflect 2006 changes made to the disclosure rules by the Securities and Exchange Commission, Notice 2007-49, 2007-25 I.R.B. 1429, provides that “covered employee” means any employee who is (1) the principal executive officer (or an individual acting in such capacity) within the meaning of the amended disclosure rules, or (2) among the three most highly compensated officers for the taxable year (other than the principal executive officer).

<sup>266</sup> Sec. 6511(a).

zen as of November 1, 2012, receives an airline payment amount under a Federal bankruptcy order in a case filed on November 29, 2011, and, subject to the 90 percent limitation described above, contributes any portion of the airline payment amount to a traditional IRA within 180 days of receipt of the amount,<sup>267</sup> the amount contributed is treated as a rollover contribution to the traditional IRA and may be excluded from gross income for the taxable year in which the airline payment amount was paid to the qualified airline employee.<sup>268</sup>

Under the provision, a qualified airline employee who excludes from income an airline payment amount contributed to a traditional IRA may file a claim for a refund until the later of (1) the usual period of limitation (generally, three years from the time the return was filed or two years from the time the tax was paid, whichever period expires later), or (2) April 15, 2015.

#### ***Effective Date***

The provision is effective on the date of enactment (December 18, 2014).

---

<sup>267</sup> Rollover contribution treatment (and the related exclusion from income) applies to an airline payment amount (or portion thereof) contributed to a traditional IRA within 180 days. A legislative change may be needed for the provision to apply with respect to airline payment amounts received more than 180 days before enactment.

<sup>268</sup> As permitted under present law, after the contribution, an individual may convert the traditional IRA to a Roth IRA.

**PART ELEVEN: GRAND PORTAGE BAND PER CAPITA  
ADJUSTMENT ACT (PUBLIC LAW 113-290) <sup>269</sup>**

**A. Equal Treatment of Certain Per Capita Income For  
Purposes of Federal Assistance (sec. 2 of the Act)**

***Present Law***

Section 1407 of Title 25 of the United States Code (Indians) exempts certain per capita payments from Federal and State income taxes and from treatment as income for purposes of determining eligibility for Social Security and Federal assistance programs.

Section 7873 of the Internal Revenue Code provides that no income or employment tax is imposed on income derived by Indians from a fishing rights-related activity. The IRS has found that “income derived from a fishing rights-related activity” includes per capita payments to tribal members from a tribe’s settlement of an action for declaratory judgment prohibiting State regulation of fishing on treaty waters.<sup>270</sup> The IRS’s rationale was that the amount of the settlement payment to the tribe was intended to approximate the loss of potential fishing income that would result from the State regulation imposed by the settlement agreement.

***Explanation of Provision***

The provision amends section 1407 of Title 25 of the United States Code to include certain payments made by the State of Minnesota to the Grand Portage Band of Lake Superior Chippewa Indians (the “Tribe”). These payments result from a settlement under which the Tribe agreed to restrict their members from exercising their fishing rights.

***Effective Date***

The provision is effective on the date of enactment (December 19, 2014).

---

<sup>269</sup> H.R. 3608. The House Committee on Natural Resources reported H.R. 3608 on November 17, 2014 (H.R. Rep. 113-625 (Part 1)). The House passed the bill on November 17, 2014. The Senate passed the bill without amendment on December 16, 2014. The President signed the bill on December 19, 2014.

<sup>270</sup> Technical Advice Memorandum 9747004, July 25, 1997.

**PART TWELVE: TAX INCREASE PREVENTION ACT OF  
2014 AND THE STEPHEN BECK, JR., ACHIEVING A BET-  
TER LIFE EXPERIENCE ACT OF 2014 (PUBLIC LAW 113-  
295) <sup>271</sup>**

**DIVISION A—TAX INCREASE PREVENTION ACT OF 2014**

**TITLE I—CERTAIN EXPIRING PROVISIONS**

**A. Subtitle A—Individual Tax Extenders**

**1. Extension of deduction for certain expenses of elementary  
and secondary school teachers (sec. 101 of the Act and  
sec. 62(a)(2)(D) of the Code)**

*Present Law*

In general, ordinary and necessary business expenses are deductible. However, unreimbursed employee business expenses generally are deductible only as an itemized deduction and only to the extent that the individual's total miscellaneous deductions (including employee business expenses) exceed two percent of adjusted gross income. For taxable years beginning after 2012, an individual's otherwise allowable itemized deductions may be further limited by the overall limitation on itemized deductions, which reduces itemized deductions for taxpayers with adjusted gross income in excess of a threshold amount. In addition, miscellaneous itemized deductions are not allowable under the alternative minimum tax.

Certain expenses of eligible educators are allowed as an above-the-line deduction. Specifically, for taxable years beginning prior to January 1, 2014, an above-the-line deduction is allowed for up to \$250 annually of expenses paid or incurred by an eligible educator for books, supplies (other than nonathletic supplies for courses of

---

<sup>271</sup> H.R. 5771. The Senate Committee on Finance reported S. 2260 ("EXPIRE Act of 2014") on April 28, 2014 (S. Rep. No. 113-154) and S. 2261 ("Tax Technical Corrections Act of 2014") on April 28, 2014 (S. Rep. No. 113-155). The EXPIRE Act generally extended expiring provisions through 2015 with some modifications. The House Committee on Ways and Means reported H.R. 647 ("Achieving a Better Life Experience Act of 2014") on November 12, 2014 (H.R. Rep. No. 113-614 (Part 1)). The House passed H.R. 5771 ("Tax Increase Prevention Act of 2014") and H.R. 647 on December 3, 2014. In the engrossment of H.R. 5771, the text of H.R. 647 was added as Division B. The Senate passed the bill without amendment on December 16, 2014. The President signed the bill on December 19, 2014.

The House Ways and Means Committee reported the following bills relating to the modification and making permanent or extending certain expiring provisions: H.R. 4453 ("S Corporation Permanent Tax Relief Act of 2014") on May 2, 2014 (H.R. Rep. No. 113-429), H.R. 4454 ("Permanent S Corporation Charitable Contributions Act of 2014") on May 2, 2014 (H.R. Rep. No. 113-430), H.R. 4438 ("American Research and Competitiveness Act of 2014") on May 2, 2014 (H.R. Rep. No. 113-431), H.R. 4457 ("America's Small Business Tax Relief Act of 2014") on May 2, 2014 (H.R. Rep. No. 113-432), H.R. 4719 ("America Gives More Act of 2014") on June 26, 2014 (H.R. Rep. 113-498), H.R. 2807 ("Conservation Easement Incentive Act of 2014") on June 26, 2014 (H. Rep. No. 113-494), H.R. 4619 ("Permanent IRA Charitable Contribution Act of 2014") on June 26, 2014 (H.R. Rep. No. 113-496), and H.R. 4718 (A bill to amend the Internal Revenue Code of 1986 to modify and make permanent bonus depreciation) on July 3, 2014 (H.R. Rep. No. 113-509). Each of the bills passed the House, either separately or in a bill combining certain of the provisions.

instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by the eligible educator in the classroom.<sup>272</sup> To be eligible for this deduction, the expenses must be otherwise deductible under section 162 as a trade or business expense. A deduction is allowed only to the extent the amount of expenses exceeds the amount excludable from income under section 135 (relating to education savings bonds), 529(c)(1) (relating to qualified tuition programs), and section 530(d)(2) (relating to Coverdell education savings accounts).

An eligible educator is a kindergarten through grade twelve teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during a school year. A school means any school that provides elementary education or secondary education (kindergarten through grade 12), as determined under State law.

The above-the-line deduction for eligible educators is not allowed for taxable years beginning after December 31, 2013.

### ***Explanation of Provision***

The provision extends the deduction for eligible educator expenses for one year, through December 31, 2014.

### ***Effective Date***

The provision applies to taxable years beginning after December 31, 2013.

## **2. Extension of exclusion from gross income of discharges of acquisition indebtedness on principal residences (sec. 102 of the Act and sec. 108 of the Code)**

### ***Present Law***

#### ***In general***

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain student loans, certain farm indebtedness, and certain real property business indebtedness (secs. 61(a)(12) and 108).<sup>273</sup> In cases involving discharges of indebtedness that are excluded from gross income under the exceptions to the general rule, taxpayers generally reduce certain tax attributes, including basis in property, by the amount of the discharge of indebtedness.

The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a Title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. In the case of a discharge in bankruptcy or where the debtor is insolvent, any reduction in basis may not exceed the excess of the aggregate bases of properties held by the taxpayer immediately after the discharge over the aggregate of the liabilities of the taxpayer immediately after the discharge (sec. 1017).

<sup>272</sup> Sec. 62(a)(2)(D).

<sup>273</sup> A debt cancellation which constitutes a gift or bequest is not treated as income to the donee debtor (sec. 102).



For all taxpayers, the amount of discharge of indebtedness generally is equal to the difference between the adjusted issue price of the debt being cancelled and the amount used to satisfy the debt. These rules generally apply to the exchange of an old obligation for a new obligation, including a modification of indebtedness that is treated as an exchange (a debt-for-debt exchange).

***Qualified principal residence indebtedness***

An exclusion from gross income is provided for any discharge of indebtedness income by reason of a discharge (in whole or in part) of qualified principal residence indebtedness. Qualified principal residence indebtedness means acquisition indebtedness (within the meaning of section 163(h)(3)(B), except that the dollar limitation is \$2 million) with respect to the taxpayer's principal residence. Acquisition indebtedness with respect to a principal residence generally means indebtedness which is incurred in the acquisition, construction, or substantial improvement of the principal residence of the individual and is secured by the residence. It also includes refinancing of such indebtedness to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness. For these purposes, the term "principal residence" has the same meaning as under section 121 of the Code.

If, immediately before the discharge, only a portion of a discharged indebtedness is qualified principal residence indebtedness, the exclusion applies only to so much of the amount discharged as exceeds the portion of the debt which is not qualified principal residence indebtedness. Thus, assume that a principal residence is secured by an indebtedness of \$1 million, of which \$800,000 is qualified principal residence indebtedness. If the residence is sold for \$700,000 and \$300,000 debt is discharged, then only \$100,000 of the amount discharged may be excluded from gross income under the qualified principal residence indebtedness exclusion.

The basis of the individual's principal residence is reduced by the amount excluded from income under the provision.

The qualified principal residence indebtedness exclusion does not apply to a taxpayer in a Title 11 case; instead the general exclusion rules apply. In the case of an insolvent taxpayer not in a Title 11 case, the qualified principal residence indebtedness exclusion applies unless the taxpayer elects to have the general exclusion rules apply instead.

The exclusion does not apply to the discharge of a loan if the discharge is on account of services performed for the lender or any other factor not directly related to a decline in the value of the residence or to the financial condition of the taxpayer.

The exclusion for qualified principal residence indebtedness is effective for discharges of indebtedness before January 1, 2014.

***Explanation of Provision***

The provision extends for one year (through December 31, 2014) the exclusion from gross income for discharges of qualified principal residence indebtedness.

### ***Effective Date***

The provision applies to discharges of indebtedness on or after January 1, 2014.

### **3. Extension of parity for employer-provided mass transit and parking benefits (sec. 103 of the Act and 132(f) of the Code)**

#### ***Present Law***

#### ***Qualified transportation fringes***

Qualified transportation fringe benefits provided by an employer are excluded from an employee's gross income for income tax purposes and from an employee's wages for employment tax purposes.<sup>274</sup> Qualified transportation fringe benefits include parking, transit passes, vanpool benefits, and qualified bicycle commuting reimbursements.

No amount is includible in the income of an employee merely because the employer offers the employee a choice between cash and qualified transportation fringe benefits (other than a qualified bicycle commuting reimbursement).

Qualified transportation fringe benefits also include a cash reimbursement (under a bona fide reimbursement arrangement) by an employer to an employee for parking, transit passes, or vanpooling. In the case of transit passes, however, a cash reimbursement is considered a qualified transportation fringe benefit only if a voucher or similar item that may be exchanged only for a transit pass is not readily available for direct distribution by the employer to the employee.

#### ***Mass transit parity***

Before February 17, 2009, the amount that could be excluded as qualified transportation fringe benefits was limited to \$100 per month in combined transit pass and vanpool benefits and \$175 per month in qualified parking benefits. These limits are adjusted annually for inflation, using 1998 as the base year; for 2014, the limits are \$130 and \$250, respectively. Effective for months beginning on or after February 17, 2009,<sup>275</sup> and before January 1, 2014, parity in qualified transportation fringe benefits is provided by temporarily increasing the monthly exclusion for combined employer-provided transit pass and vanpool benefits to the same level as the exclusion for employer-provided parking.

Effective January 1, 2014, the amount that can be excluded as qualified transportation fringe benefits is limited to \$130 per month in combined transit pass and vanpool benefits and \$250 per month in qualified parking benefits. These amounts apply also for 2015.

<sup>274</sup> Secs. 132(a)(5) and (f), 3121(a)(20), 3231(e)(5), 3306(b)(16) and 3401(a)(19).

<sup>275</sup> Parity was originally provided by the American Recovery and Reinvestment Act of 2009 ("ARRA"), Pub. L. No. 111-5, effective for months beginning on or after February 17, 2009, the date of enactment of ARRA.

### ***Explanation of Provision***

The provision extends parity in the exclusion for combined employer-provided transit pass and vanpool benefits and for employer-provided parking benefits for one year, through months beginning before January 1, 2015. Thus, for 2014, the monthly limit on the exclusion for combined transit pass and vanpool benefits is \$250, the same as the monthly limit on the exclusion for qualified parking benefits.

In order for the extension to be effective retroactive to January 1, 2014, expenses incurred during 2014 by an employee for employer-provided transit and vanpool benefits may be reimbursed (under a bona fide reimbursement arrangement) by employers on a tax-free basis to the extent they exceed \$130 per month and are no more than \$250 per month. The Congress intends that the rule that an employer reimbursement is excludible only if vouchers are not available to provide the benefit continues to apply, except in the case of reimbursements for transit or vanpool benefits between \$130 and \$250 for months during 2014. Further, the Congress intends that reimbursements for expenses incurred for months during 2014 may be made in addition to the provision of excludible benefits or reimbursements for expenses incurred during 2015.

### ***Effective Date***

The provision is effective for months after December 31, 2013.

## **4. Extension of mortgage insurance premiums treated as qualified residence interest (sec. 104 of the Act and sec. 163 of the Code)**

### ***Present Law***

#### ***In general***

Present law provides that qualified residence interest is deductible notwithstanding the general rule that personal interest is non-deductible.<sup>276</sup>

#### ***Acquisition indebtedness and home equity indebtedness***

Qualified residence interest is interest on acquisition indebtedness and home equity indebtedness with respect to a principal and a second residence of the taxpayer. The maximum amount of home equity indebtedness is \$100,000. The maximum amount of acquisition indebtedness is \$1 million. Acquisition indebtedness means debt that is incurred in acquiring, constructing, or substantially improving a qualified residence of the taxpayer, and that is secured by the residence. Home equity indebtedness is debt (other than acquisition indebtedness) that is secured by the taxpayer's principal or second residence, to the extent the aggregate amount of such debt does not exceed the difference between the total acquisition indebtedness with respect to the residence, and the fair market value of the residence.

<sup>276</sup>Sec. 163(h).

### ***Qualified mortgage insurance***

Certain premiums paid or accrued for qualified mortgage insurance by a taxpayer during the taxable year in connection with acquisition indebtedness on a qualified residence of the taxpayer are treated as interest that is qualified residence interest and thus deductible. The amount allowable as a deduction is phased out ratably by 10 percent for each \$1,000 (or fraction thereof) by which the taxpayer's adjusted gross income exceeds \$100,000 (\$500 and \$50,000, respectively, in the case of a married individual filing a separate return). Thus, the deduction is not allowed if the taxpayer's adjusted gross income exceeds \$109,000 (\$54,000 in the case of married individual filing a separate return).

For this purpose, qualified mortgage insurance means mortgage insurance provided by the Department of Veterans Affairs, the Federal Housing Administration, or the Rural Housing Service, and private mortgage insurance (defined in section two of the Homeowners Protection Act of 1998 as in effect on the date of enactment of the provision).

Amounts paid for qualified mortgage insurance that are properly allocable to periods after the close of the taxable year are treated as paid in the period to which they are allocated. No deduction is allowed for the unamortized balance if the mortgage is paid before its term (except in the case of qualified mortgage insurance provided by the Department of Veterans Affairs or Rural Housing Service).

The provision does not apply with respect to any mortgage insurance contract issued before January 1, 2007. The provision terminates for any amount paid or accrued after December 31, 2013, or properly allocable to any period after that date.

Reporting rules apply under the provision.

### ***Explanation of Provision***

The provision extends the deduction for qualified mortgage insurance premiums for one year (with respect to contracts entered into after December 31, 2006). Thus, the provision applies to amounts paid or accrued in 2014 (and not properly allocable to any period after 2014).

### ***Effective Date***

The provision applies to amounts paid or accrued after December 31, 2013.

## **5. Extension of deduction for State and local general sales taxes (sec. 105 of the Act and sec. 164 of the Code)**

### ***Present Law***

For purposes of determining regular tax liability, an itemized deduction is permitted for certain State and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. The itemized deduction is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. For taxable years beginning before January 1, 2014, at the election of the taxpayer, an itemized deduction may be taken for State and

local general sales taxes in lieu of the itemized deduction provided under present law for State and local income taxes. As is the case for State and local income taxes, the itemized deduction for State and local general sales taxes is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. Taxpayers have two options with respect to the determination of the sales tax deduction amount. Taxpayers may deduct the total amount of general State and local sales taxes paid by accumulating receipts showing general sales taxes paid. Alternatively, taxpayers may use tables created by the Secretary that show the allowable deduction. The tables are based on average consumption by taxpayers on a State-by-State basis taking into account number of dependents, modified adjusted gross income and rates of State and local general sales taxation. Taxpayers who live in more than one jurisdiction during the tax year are required to pro-rate the table amounts based on the time they live in each jurisdiction. Taxpayers who use the tables created by the Secretary may, in addition to the table amounts, deduct eligible general sales taxes paid with respect to the purchase of motor vehicles, boats, and other items specified by the Secretary. Sales taxes for items that may be added to the tables are not reflected in the tables themselves.

A general sales tax is a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items.<sup>277</sup> No deduction is allowed for any general sales tax imposed with respect to an item at a rate other than the general rate of tax. However, in the case of food, clothing, medical supplies, and motor vehicles, the above rules are relaxed in two ways. First, if the tax does not apply with respect to some or all of such items, a tax that applies to other such items can still be considered a general sales tax. Second, the rate of tax applicable with respect to some or all of these items may be lower than the general rate. However, in the case of motor vehicles, if the rate of tax exceeds the general rate, such excess is disregarded and the general rate is treated as the rate of tax.

A compensating use tax with respect to an item is treated as a general sales tax, provided such tax is complementary to a general sales tax and a deduction for sales taxes is allowable with respect to items sold at retail in the taxing jurisdiction that are similar to such item.

### ***Explanation of Provision***

The provision extends the provision allowing taxpayers to elect to deduct State and local sales taxes in lieu of State and local income taxes for one year, through December 31, 2014.

### ***Effective Date***

The provision applies to taxable years beginning after December 31, 2013.

---

<sup>277</sup> Sec. 164(b)(5)(B).

## **6. Extension of special rule for contributions of capital gain real property made for conservation purposes (sec. 106 of the Act and sec. 170(b) of the Code)**

### ***Present Law***

#### ***Charitable contributions generally***

In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of deduction generally equals the fair market value of the contributed property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes.<sup>278</sup>

In general, in any taxable year, charitable contributions by a corporation are not deductible to the extent the aggregate contributions exceed 10 percent of the corporation's taxable income computed without regard to net operating or capital loss carrybacks. Total deductible contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations generally may not exceed 50 percent of the taxpayer's contribution base, which is the taxpayer's adjusted gross income for a taxable year (disregarding any net operating loss carryback). To the extent a taxpayer has not exceeded the 50-percent limitation, (1) contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's contribution base, (2) contributions of cash to most private nonoperating foundations and certain other charitable organizations generally may be deducted up to 30 percent of the taxpayer's contribution base, and (3) contributions of capital gain property to private foundations and certain other charitable organizations generally may be deducted up to 20 percent of the taxpayer's contribution base.

Contributions in excess of the applicable percentage limits generally may be carried over and deducted over the next five taxable years, subject to the relevant percentage limitations on the deduction in each of those years.

#### ***Capital gain property***

Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of capital gain property to a qualified charity are deductible at fair market value within certain limitations. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(A) (e.g., public charities, private foundations other than private non-operating foundations, and certain governmental units) generally are deductible up to 30 percent of the taxpayer's contribution base. An individual may elect, however, to bring all these contributions of capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital

<sup>278</sup> Secs. 170, 2055, and 2522, respectively.

gain property. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(B) (*e.g.*, private non-operating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

For purposes of determining whether a taxpayer's aggregate charitable contributions in a taxable year exceed the applicable percentage limitation, contributions of capital gain property are taken into account after other charitable contributions.

### ***Qualified conservation contributions***

Qualified conservation contributions are one exception to the "partial interest" rule, which generally bars deductions for charitable contributions of partial interests in property.<sup>279</sup> A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest is defined as: (1) the entire interest of the donor other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction (granted in perpetuity) on the use that may be made of the real property. Qualified organizations include certain governmental units, public charities that meet certain public support tests, and certain supporting organizations. Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.

Qualified conservation contributions of capital gain property are subject to the same limitations and carryover rules as other charitable contributions of capital gain property.

### ***Temporary rules regarding contributions of capital gain real property for conservation purposes***

#### *In general*

Under a temporary provision<sup>280</sup> the 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions (as defined under present law). Instead, individuals may deduct the fair market value of any qualified conservation contribution to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable charitable contributions. These contributions are not taken into account in determining the amount of other allowable charitable contributions.

Individuals are allowed to carry over any qualified conservation contributions that exceed the 50-percent limitation for up to 15 years.

<sup>279</sup> Secs. 170(f)(3)(B)(iii) and 170(h).

<sup>280</sup> Sec. 170(b)(1)(E).

For example, assume an individual with a contribution base of \$100 makes a qualified conservation contribution of property with a fair market value of \$80 and makes other charitable contributions subject to the 50-percent limitation of \$60. The individual is allowed a deduction of \$50 in the current taxable year for the non-conservation contributions (50 percent of the \$100 contribution base) and is allowed to carry over the excess \$10 for up to 5 years. No current deduction is allowed for the qualified conservation contribution, but the entire \$80 qualified conservation contribution may be carried forward for up to 15 years.

#### *Farmers and ranchers*

In the case of an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a qualified conservation contribution is allowable up to 100 percent of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions.

In the above example, if the individual is a qualified farmer or rancher, in addition to the \$50 deduction for non-conservation contributions, an additional \$50 for the qualified conservation contribution is allowed and \$30 may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under section 170(b)(2)) over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.<sup>281</sup>

As an additional condition of eligibility for the 100 percent limitation, with respect to any contribution of property in agriculture or livestock production, or that is available for such production, by a qualified farmer or rancher, the qualified real property interest must include a restriction that the property remain generally available for such production. (There is no requirement as to any specific use in agriculture or farming, or necessarily that the property be used for such purposes, merely that the property remain available for such purposes.)

A qualified farmer or rancher means a taxpayer whose gross income from the trade or business of farming (within the meaning of section 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.

#### *Termination*

The temporary rules regarding contributions of capital gain real property for conservation purposes do not apply to contributions made in taxable years beginning after December 31, 2013.<sup>282</sup>

<sup>281</sup> Sec. 170(b)(2)(B).

<sup>282</sup> Secs. 170(b)(1)(E)(vi) and 170(b)(2)(B)(iii).



### ***Explanation of Provision***

The provision extends the increased percentage limits and extended carryforward period for contributions of capital gain real property for conservation purposes for one year, *i.e.*, for contributions made in taxable years beginning before January 1, 2015.

### ***Effective Date***

The provision is effective for contributions made in taxable years beginning after December 31, 2103.

## **7. Extension of above-the-line deduction for qualified tuition and related expenses (sec. 107 of the Act and sec. 222 of the Code)**

### ***Present Law***

An individual is allowed a deduction for qualified tuition and related expenses for higher education paid by the individual during the taxable year.<sup>283</sup> The deduction is allowed in computing adjusted gross income. The term qualified tuition and related expenses is defined in the same manner as for the Hope and Lifetime Learning credits, and includes tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer with respect to whom the taxpayer may claim a personal exemption, at an eligible institution of higher education for courses of instruction of such individual at such institution.<sup>284</sup> The expenses must be in connection with enrollment at an institution of higher education during the taxable year, or with an academic period beginning during the taxable year or during the first three months of the next taxable year. The deduction is not available for tuition and related expenses paid for elementary or secondary education.

The maximum deduction is \$4,000 for an individual whose adjusted gross income for the taxable year does not exceed \$65,000 (\$130,000 in the case of a joint return), or \$2,000 for other individuals whose adjusted gross income does not exceed \$80,000 (\$160,000 in the case of a joint return). No deduction is allowed for an individual whose adjusted gross income exceeds the relevant adjusted gross income limitations, for a married individual who does not file a joint return, or for an individual with respect to whom a personal exemption deduction may be claimed by another taxpayer for the taxable year. The deduction is not available for taxable years beginning after December 31, 2013.

The amount of qualified tuition and related expenses must be reduced by certain scholarships, educational assistance allowances, and other amounts paid for the benefit of such individual,<sup>285</sup> and by the amount of such expenses taken into account for purposes of determining any exclusion from gross income of: (1) income from certain U.S. savings bonds used to pay higher education tuition

<sup>283</sup> Sec. 222.

<sup>284</sup> The deduction generally is not available for expenses with respect to a course or education involving sports, games, or hobbies, and is not available for student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic course of instruction.

<sup>285</sup> Secs. 222(d)(1) and 25A(g)(2).

and fees; and (2) income from a Coverdell education savings account.<sup>286</sup> Additionally, such expenses must be reduced by the earnings portion (but not the return of principal) of distributions from a qualified tuition program if an exclusion under section 529 is claimed with respect to expenses eligible for the qualified tuition deduction. No deduction is allowed for any expense for which a deduction is otherwise allowed or with respect to an individual for whom a Hope or Lifetime Learning credit is elected for such taxable year.

### ***Explanation of Provision***

The provision extends the qualified tuition deduction for one year, through 2014.

### ***Effective Date***

The provision applies to taxable years beginning after December 31, 2013.

## **8. Extension of tax-free distributions from individual retirement plans for charitable purposes (sec. 108 of the Act and sec. 408(d)(8) of the Code)**

### ***Present Law***

#### ***In general***

If an amount withdrawn from a traditional individual retirement arrangement (“IRA”) or a Roth IRA is donated to a charitable organization, the rules relating to the tax treatment of withdrawals from IRAs apply to the amount withdrawn and the charitable contribution is subject to the normally applicable limitations on deductibility of such contributions. An exception applies in the case of a qualified charitable distribution.

#### ***Charitable contributions***

In computing taxable income, an individual taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and up to the fair market value of property contributed to the following entities: (1) a charity described in section 170(c)(2); (2) certain veterans’ organizations, fraternal societies, and cemetery companies;<sup>287</sup> and (3) a Federal, State, or local governmental entity, but only if the contribution is made for exclusively public purposes.<sup>288</sup> The deduction also is allowed for purposes of calculating alternative minimum taxable income.

The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.<sup>289</sup>

<sup>286</sup> Sec. 222(c). These reductions are the same as those that apply to the Hope and Lifetime Learning credits.

<sup>287</sup> Secs. 170(c)(3)–(5).

<sup>288</sup> Sec. 170(c)(1).

<sup>289</sup> Secs. 170(b) and (e).

A taxpayer who takes the standard deduction (i.e., who does not itemize deductions) may not take a separate deduction for charitable contributions.<sup>290</sup>

A payment to a charity (regardless of whether it is termed a “contribution”) in exchange for which the donor receives an economic benefit is not deductible, except to the extent that the donor can demonstrate, among other things, that the payment exceeds the fair market value of the benefit received from the charity. To facilitate distinguishing charitable contributions from purchases of goods or services from charities, present law provides that no charitable contribution deduction is allowed for a separate contribution of \$250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service provided) to the taxpayer in consideration for the contribution.<sup>291</sup> In addition, present law requires that any charity that receives a contribution exceeding \$75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a “quid pro quo” contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that only the portion exceeding the value of the goods or services may be deductible as a charitable contribution.<sup>292</sup>

Under present law, total deductible contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations generally may not exceed 50 percent of the taxpayer’s contribution base, which is the taxpayer’s adjusted gross income for a taxable year (disregarding any net operating loss carryback). To the extent a taxpayer has not exceeded the 50-percent limitation, (1) contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer’s contribution base, (2) contributions of cash to most private nonoperating foundations and certain other charitable organizations generally may be deducted up to 30 percent of the taxpayer’s contribution base, and (3) contributions of capital gain property to private foundations and certain other charitable organizations generally may be deducted up to 20 percent of the taxpayer’s contribution base.

Contributions by individuals in excess of the 50-percent, 30-percent, and 20-percent limits generally may be carried over and deducted over the next five taxable years, subject to the relevant percentage limitations on the deduction in each of those years.

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity (e.g., a remainder) while also either retaining an interest in that property (e.g., an income interest) or transferring an interest in that property to a noncharity for less than full and

<sup>290</sup> Sec. 170(a).

<sup>291</sup> Sec. 170(f)(8). For any contribution of a cash, check, or other monetary gift, no deduction is allowed unless the donor maintains as a record of such contribution a bank record or written communication from the donee charity showing the name of the donee organization, the date of the contribution, and the amount of the contribution. Sec. 170(f)(17).

<sup>292</sup> Sec. 6115.

adequate consideration.<sup>293</sup> Exceptions to this general rule are provided for, among other interests, remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds, and present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property.<sup>294</sup> For such interests, a charitable deduction is allowed to the extent of the present value of the interest designated for a charitable organization.

### ***IRA rules***

Within limits, individuals may make deductible and nondeductible contributions to a traditional IRA. Amounts in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal represents a return of nondeductible contributions). Certain individuals also may make nondeductible contributions to a Roth IRA (deductible contributions cannot be made to Roth IRAs). Qualified withdrawals from a Roth IRA are excludable from gross income. Withdrawals from a Roth IRA that are not qualified withdrawals are includible in gross income to the extent attributable to earnings. Includible amounts withdrawn from a traditional IRA or a Roth IRA before attainment of age 59½ are subject to an additional 10-percent early withdrawal tax, unless an exception applies. Under present law, minimum distributions are required to be made from tax-favored retirement arrangements, including IRAs. Minimum required distributions from a traditional IRA must generally begin by April 1 of the calendar year following the year in which the IRA owner attains age 70½.<sup>295</sup>

If an individual has made nondeductible contributions to a traditional IRA, a portion of each distribution from an IRA is nontaxable until the total amount of nondeductible contributions has been received. In general, the amount of a distribution that is nontaxable is determined by multiplying the amount of the distribution by the ratio of the IRA's nondeductible contributions to the IRA's account balance. In making the calculation, all traditional IRAs of an individual are treated as a single IRA, all distributions during any taxable year are treated as a single distribution, and, in general, the value of the account, income on the account, and investment in the contract (basis) are computed as of the close of the calendar year.

In the case of a distribution from a Roth IRA that is not a qualified distribution, in determining the portion of the distribution attributable to earnings, contributions and distributions are deemed to be distributed in the following order: (1) regular Roth IRA contributions; (2) taxable conversion contributions;<sup>296</sup> (3) nontaxable conversion contributions; and (4) earnings. In determining the amount of taxable distributions from a Roth IRA, all Roth IRA distributions in the same taxable year are treated as a single distribution, all regular Roth IRA contributions for a year are treated as

<sup>293</sup> Secs. 170(f), 2055(e)(2), and 2522(c)(2).

<sup>294</sup> Sec. 170(f)(2).

<sup>295</sup> Minimum distribution rules also apply in the case of distributions after the death of a traditional or Roth IRA owner.

<sup>296</sup> Conversion contributions refer to conversions of amounts in a traditional IRA to a Roth IRA.

a single contribution, and all conversion contributions during the year are treated as a single contribution.

Taxable distributions from an IRA are generally subject to withholding unless the individual elects not to have withholding apply.<sup>297</sup> Elections not to have withholding apply are to be made in the time and manner prescribed by the Secretary.

### ***Qualified charitable distributions***

Otherwise taxable IRA distributions from a traditional or Roth IRA are excluded from gross income to the extent they are qualified charitable distributions.<sup>298</sup> The amount excluded may not exceed \$100,000 per taxpayer per taxable year. Special rules apply in determining the amount of an IRA distribution that is otherwise taxable. The otherwise applicable rules regarding taxation of IRA distributions and the deduction of charitable contributions continue to apply to distributions from an IRA that are not qualified charitable distributions. A qualified charitable distribution is taken into account for purposes of the minimum distribution rules applicable to traditional IRAs to the same extent the distribution would have been taken into account under such rules had the distribution not been directly distributed under the qualified charitable distribution provision. An IRA does not fail to qualify as an IRA as a result of qualified charitable distributions being made from the IRA.

A qualified charitable distribution is any distribution from an IRA directly by the IRA trustee to an organization described in section 170(b)(1)(A) (other than an organization described in section 509(a)(3) or a donor advised fund (as defined in section 4966(d)(2))). Distributions are eligible for the exclusion only if made on or after the date the IRA owner attains age 70½ and only to the extent the distribution would be includible in gross income (without regard to this provision).

The exclusion applies only if a charitable contribution deduction for the entire distribution otherwise would be allowable (under present law), determined without regard to the generally applicable percentage limitations. Thus, for example, if the deductible amount is reduced because of a benefit received in exchange, or if a deduction is not allowable because the donor did not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution.

If the IRA owner has any IRA that includes nondeductible contributions, a special rule applies in determining the portion of a distribution that is includible in gross income (but for the qualified charitable distribution provision) and thus is eligible for qualified charitable distribution treatment. Under the special rule, the distribution is treated as consisting of income first, up to the aggregate amount that would be includible in gross income (but for the qualified charitable distribution provision) if the aggregate balance of all IRAs having the same owner were distributed during the same year. In determining the amount of subsequent IRA distributions includible in income, proper adjustments are to be made to

<sup>297</sup> Sec. 3405.

<sup>298</sup> Sec. 408(d)(8). The exclusion does not apply to distributions from employer-sponsored retirement plans, including SIMPLE IRAs and simplified employee pensions ("SEPs").

reflect the amount treated as a qualified charitable distribution under the special rule.

Distributions that are excluded from gross income by reason of the qualified charitable distribution provision are not taken into account in determining the deduction for charitable contributions under section 170.

Under present law, the exclusion does not apply to distributions made in taxable years beginning after December 31, 2013.

### ***Explanation of Provision***

The provision extends the exclusion from gross income for qualified charitable distributions from an IRA for one year, *i.e.*, for distributions made in taxable years beginning before January 1, 2015.

### ***Effective Date***

The provision is effective for distributions made in taxable years beginning after December 31, 2013.

## **B. Subtitle B—Business Tax Extenders**

### **1. Extension of research credit (sec. 111 of the Act and sec. 41 of the Code)**

#### ***Present Law***

#### ***General rule***

For general research expenditures, a taxpayer may claim a research credit equal to 20 percent of the amount by which the taxpayer's qualified research expenses for a taxable year exceed its base amount for that year.<sup>299</sup> Thus, the research credit is generally available with respect to incremental increases in qualified research. An alternative simplified research credit (with a 14 percent rate and a different base amount) may be claimed in lieu of this credit.<sup>300</sup>

A 20-percent research tax credit also is available with respect to the excess of (1) 100 percent of corporate cash expenses (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over (2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation.<sup>301</sup> This separate credit computation commonly is referred to as the basic research credit.

Finally, a research credit is available for a taxpayer's expenditures on research undertaken by an energy research consortium.<sup>302</sup> This separate credit computation commonly is referred to as the energy research credit. Unlike the other research credits, the en-

<sup>299</sup> Sec. 41(a)(1).

<sup>300</sup> Sec. 41(c)(5).

<sup>301</sup> Secs. 41(a)(2) and 41(e). The base period for the basic research credit generally extends from 1981 through 1983.

<sup>302</sup> Sec. 41(a)(3).

ergy research credit applies to all qualified expenditures, not just those in excess of a base amount.

The research credit, including the basic research credit and the energy research credit, expires for amounts paid or incurred after December 31, 2013.<sup>303</sup>

### ***Computation of general research credit***

The general research tax credit applies only to the extent that the taxpayer's qualified research expenses for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's fixed-base percentage by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenses and had gross receipts during each of at least three years from 1984 through 1988, then its fixed-base percentage is the ratio that its total qualified research expenses for the 1984–1988 period bears to its total gross receipts for that period (subject to a maximum fixed-base percentage of 16 percent). Special rules apply to all other taxpayers (so called start-up firms).<sup>304</sup> In computing the research credit, a taxpayer's base amount cannot be less than 50 percent of its current-year qualified research expenses.

### ***Alternative simplified credit***

The alternative simplified research credit is equal to 14 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years.<sup>305</sup> The rate is reduced to six percent if a taxpayer has no qualified research expenses in any one of the three preceding taxable years.<sup>306</sup> An election to use the alternative simplified credit applies to all succeeding taxable years unless revoked with the consent of the Secretary.<sup>307</sup>

### ***Eligible expenses***

Qualified research expenses eligible for the research tax credit consist of: (1) in-house expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid or incurred by the taxpayer to certain other persons for qualified research conducted on the taxpayer's behalf (so-called

<sup>303</sup>Sec. 41(h).

<sup>304</sup>The Small Business Job Protection Act of 1996 expanded the definition of start-up firms under section 41(c)(3)(B)(i) to include any firm if the first taxable year in which such firm had both gross receipts and qualified research expenses began after 1983. A special rule (enacted in 1993) is designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm is assigned a fixed-base percentage of three percent for each of its first five taxable years after 1993 in which it incurs qualified research expenses. A start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenses is a phased-in ratio based on the firm's actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage is its actual ratio of qualified research expenses to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993. Sec. 41(c)(3)(B).

<sup>305</sup>Sec. 41(c)(5)(A).

<sup>306</sup>Sec. 41(c)(5)(B).

<sup>307</sup>Sec. 41(c)(5)(C).

contract research expenses).<sup>308</sup> Notwithstanding the limitation for contract research expenses, qualified research expenses include 100 percent of amounts paid or incurred by the taxpayer to an eligible small business, university, or Federal laboratory for qualified energy research.

To be eligible for the credit, the research not only has to satisfy the requirements of section 174, but also must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and substantially all of the activities of which constitute elements of a process of experimentation for functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, cosmetic, or seasonal design factors.<sup>309</sup> In addition, research does not qualify for the credit if: (1) conducted after the beginning of commercial production of the business component; (2) related to the adaptation of an existing business component to a particular customer's requirements; (3) related to the duplication of an existing business component from a physical examination of the component itself or certain other information; (4) related to certain efficiency surveys, management function or technique, market research, market testing, or market development, routine data collection or routine quality control; (5) related to software developed primarily for internal use by the taxpayer; (6) conducted outside the United States, Puerto Rico, or any U.S. possession; (7) in the social sciences, arts, or humanities; or (8) funded by any grant, contract, or otherwise by another person (or government entity).<sup>310</sup>

### ***Relation to deduction***

Deductions allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year.<sup>311</sup> Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed.<sup>312</sup>

### ***Explanation of Provision***

The provision extends the present law credit for one year, for qualified research expenses paid or incurred before January 1, 2015.

<sup>308</sup> Under a special rule, 75 percent of amounts paid to a research consortium for qualified research are treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule under section 41(b)(3) governing contract research expenses) if (1) such research consortium is a tax-exempt organization that is described in section 501(c)(3) (other than a private foundation) or section 501(c)(6) and is organized and operated primarily to conduct scientific research, and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer. Sec. 41(b)(3)(C).

<sup>309</sup> Sec. 41(d)(3).

<sup>310</sup> Sec. 41(d)(4).

<sup>311</sup> Sec. 280C(c).

<sup>312</sup> Sec. 280C(c)(3).



### ***Effective Date***

The provision is effective for amounts paid or incurred after December 31, 2013.

## **2. Extension of temporary minimum low-income housing tax credit rate for non-Federally subsidized buildings (sec. 112 of the Act and sec. 42 of the Code)**

### ***Present Law***

#### ***In general***

The low-income housing credit may be claimed over a 10-year credit period after each low-income building is placed-in-service. The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building.

#### ***Present value credit***

The calculation of the applicable percentage is designed to produce a credit equal to: (1) 70 percent of the present value of the building's qualified basis in the case of newly constructed or substantially rehabilitated housing that is not Federally subsidized (the "70-percent credit"); or (2) 30 percent of the present value of the building's qualified basis in the case of newly constructed or substantially rehabilitated housing that is Federally subsidized and existing housing that is substantially rehabilitated (the "30-percent credit"). Where existing housing is substantially rehabilitated, the existing housing is eligible for the 30-percent credit and the qualified rehabilitation expenses (if not Federally subsidized) are eligible for the 70-percent credit.

### ***Calculation of the applicable percentage***

#### ***In general***

The credit percentage for a low-income building is set for the earlier of: (1) the month the building is placed in service; or (2) at the election of the taxpayer, (a) the month the taxpayer and the housing credit agency enter into a binding agreement with respect to such building for a credit allocation, or (b) in the case of a tax-exempt bond-financed project for which no credit allocation is required, the month in which the tax-exempt bonds are issued.

These credit percentages (used for the 70-percent credit and 30-percent credit) are adjusted monthly by the IRS on a discounted after-tax basis (assuming a 28-percent tax rate) based on the average of the Applicable Federal Rates for mid-term and long-term obligations for the month the building is placed in service. The discounting formula assumes that each credit is received on the last day of each year and that the present value is computed on the last day of the first year. In a project consisting of two or more buildings placed in service in different months, a separate credit percentage may apply to each building.

*Special rule*

Under this rule the applicable percentage is set at a minimum of 9 percent for newly constructed non-Federally subsidized buildings placed in service after July 30, 2008, and before January 1, 2014.

***Explanation of Provision***

The provision extends the temporary minimum applicable percentage of 9 percent for newly constructed non-Federally subsidized buildings with respect to which credit allocations are made before January 1, 2015.

***Effective Date***

The provision is effective on January 1, 2014.

**3. Extension of military housing allowance exclusion for determining whether a tenant in certain counties is low-income (sec. 113 of the Act and secs. 42 and 142 of the Code)**

***Present Law******In general***

In order to be eligible for the low-income housing credit, a qualified low-income building must be part of a qualified low-income housing project. In general, a qualified low-income housing project is defined as a project that satisfies one of two tests at the election of the taxpayer. The first test is met if 20 percent or more of the residential units in the project are both rent-restricted, and occupied by individuals whose income is 50 percent or less of area median gross income (the “20–50 test”). The second test is met if 40 percent or more of the residential units in such project are both rent-restricted, and occupied by individuals whose income is 60 percent or less of area median gross income (the “40–60 test”). These income figures are adjusted for family size.

***Rule for income determinations before July 30, 2008 and on or after January 1, 2014***

The recipients of the military basic housing allowance must include these amounts for purposes of low-income credit eligibility income test, as described above.

***Special rule for income determination before January 1, 2014***

Under the provision the basic housing allowance (*i.e.*, payments under 37 U.S.C. sec. 403) is not included in income for the low-income credit income eligibility rules. The provision is limited in application to qualified buildings. A qualified building is defined as any building located in:

1. any county which contains a qualified military installation to which the number of members of the Armed Forces assigned to units based out of such qualified military installation has increased by 20 percent or more as of June 1, 2008, over the personnel level on December 31, 2005; and

2. any counties adjacent to a county described in (1), above.

For these purposes, a qualified military installation is any military installation or facility with at least 1000 members of the Armed Forces assigned to it.

The provision applies to income determinations: (1) made after July 30, 2008, and before January 1, 2014, in the case of qualified buildings which received credit allocations on or before July 30, 2008, or qualified buildings placed in service on or before July 30, 2008, to the extent a credit allocation was not required with respect to such building by reason of 42(h)(4) (*i.e.*, such qualified building was at least 50 percent tax-exempt bond financed with bonds subject to the private activity bond volume cap) but only with respect to bonds issued before July 30, 2008; and (2) made after July 30, 2008, in the case of qualified buildings which received credit allocations after July 30, 2008 and before January 1, 2014, or qualified buildings placed in service after July 30, 2008, and before January 1, 2014, to the extent a credit allocation was not required with respect to such qualified building by reason of 42(h)(4) (*i.e.*, such qualified building was at least 50 percent tax-exempt bond financed with bonds subject to the private activity bond volume cap) but only with respect to bonds issued after July 30, 2008, and before January 1, 2014.

#### ***Explanation of Provision***

The provision extends the special rule one year (through December 31, 2014).

#### ***Effective Date***

The provision is effective as if included in the enactment of section 3005 of the Housing Assistance Tax Act of 2008.

#### **4. Extension of Indian employment tax credit (sec. 114 of the Act and sec. 45A of the Code)**

##### ***Present Law***

In general, a credit against income tax liability is allowed to employers for the first \$20,000 of qualified wages and qualified employee health insurance costs paid or incurred by the employer with respect to certain employees.<sup>313</sup> The credit is equal to 20 percent of the excess of eligible employee qualified wages and health insurance costs during the current year over the amount of such wages and costs incurred by the employer during 1993. The credit is an incremental credit, such that an employer's current-year qualified wages and qualified employee health insurance costs (up to \$20,000 per employee) are eligible for the credit only to the extent that the sum of such costs exceeds the sum of comparable costs paid during 1993. No deduction is allowed for the portion of the wages equal to the amount of the credit.

Qualified wages means wages paid or incurred by an employer for services performed by a qualified employee. A qualified em-

<sup>313</sup> Sec. 45A.

employee means any employee who is an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe, who performs substantially all of the services within an Indian reservation, and whose principal place of abode while performing such services is on or near the reservation in which the services are performed. An “Indian reservation” is a reservation as defined in section 3(d) of the Indian Financing Act of 1974<sup>314</sup> or section 4(10) of the Indian Child Welfare Act of 1978.<sup>315</sup> For purposes of the preceding sentence, section 3(d) is applied by treating “former Indian reservations in Oklahoma” as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

An employee is not treated as a qualified employee for any taxable year of the employer if the total amount of wages paid or incurred by the employer with respect to such employee during the taxable year exceeds an amount determined at an annual rate of \$30,000 (which after adjusted for inflation is \$45,000 for 2013). In addition, an employee will not be treated as a qualified employee under certain specific circumstances, such as where the employee is related to the employer (in the case of an individual employer) or to one of the employer’s shareholders, partners, or grantors. Similarly, an employee will not be treated as a qualified employee where the employee has more than a five percent ownership interest in the employer. Finally, an employee will not be considered a qualified employee to the extent the employee’s services relate to gaming activities or are performed in a building housing such activities.

The wage credit is available for wages paid or incurred in taxable years that begin on or before December 31, 2013.

### ***Explanation of Provision***

The provision extends for one year the present-law employment credit provision (through taxable years beginning on or before December 31, 2014).

### ***Effective Date***

The provision is effective for taxable years beginning after December 31, 2013.

## **5. Extension of new markets tax credit (sec. 115 of the Act and sec. 45D of the Code)**

### ***Present Law***

Section 45D provides a new markets tax credit for qualified equity investments made to acquire stock in a corporation, or a capital interest in a partnership, that is a qualified community development entity (“CDE”).<sup>316</sup> The amount of the credit allowable to

<sup>314</sup> Pub. L. No. 93–262.

<sup>315</sup> Pub. L. No. 95–608.

<sup>316</sup> Section 45D was added by section 121(a) of the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106–554.

the investor (either the original purchaser or a subsequent holder) is (1) a five-percent credit for the year in which the equity interest is purchased from the CDE and for each of the following two years, and (2) a six-percent credit for each of the following four years.<sup>317</sup> The credit is determined by applying the applicable percentage (five or six percent) to the amount paid to the CDE for the investment at its original issue, and is available to the taxpayer who holds the qualified equity investment on the date of the initial investment or on the respective anniversary date that occurs during the taxable year.<sup>318</sup> The credit is recaptured if at any time during the seven-year period that begins on the date of the original issue of the investment the entity (1) ceases to be a qualified CDE, (2) the proceeds of the investment cease to be used as required, or (3) the equity investment is redeemed.<sup>319</sup>

A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by their representation on any governing board of or any advisory board to the CDE; and (3) that is certified by the Secretary as being a qualified CDE.<sup>320</sup> A qualified equity investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired at its original issue directly (or through an underwriter) from a CDE for cash, and includes an investment of a subsequent purchaser if such investment was a qualified equity investment in the hands of the prior holder. Substantially all of the investment proceeds must be used by the CDE to make qualified low-income community investments and the investment must be designated as a qualified equity investment by the CDE. For this purpose, qualified low-income community investments include: (1) capital or equity investments in, or loans to, qualified active low-income community businesses; (2) certain financial counseling and other services to businesses and residents in low-income communities; (3) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment; or (4) an equity investment in, or loan to, another CDE.<sup>321</sup>

A “low-income community” is a population census tract with either (1) a poverty rate of at least 20 percent or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a non-metropolitan census tract, does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (as opposed to 80 percent) of statewide median family income.<sup>322</sup> For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-migration of inhabitants from the county

<sup>317</sup> Sec. 45D(a)(2).

<sup>318</sup> Sec. 45D(a)(3).

<sup>319</sup> Sec. 45D(g).

<sup>320</sup> Sec. 45D(c).

<sup>321</sup> Sec. 45D(d).

<sup>322</sup> Sec. 45D(e).

of at least 10 percent of the population of the county at the beginning of such period.

The Secretary is authorized to designate “targeted populations” as low-income communities for purposes of the new markets tax credit.<sup>323</sup> For this purpose, a “targeted population” is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994<sup>324</sup> (the “Act”) to mean individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments. Section 103(17) of the Act provides that “low-income” means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a non-metropolitan area, less than the greater of—80 percent of the area median family income, or 80 percent of the statewide non-metropolitan area median family income.<sup>325</sup> A targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under section 1391 of the Code, and is contiguous to one or more low-income communities.

A qualified active low-income community business is defined as a business that satisfies, with respect to a taxable year, the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in any low-income community; (2) a substantial portion of the tangible property of the business is used in a low-income community; (3) a substantial portion of the services performed for the business by its employees is performed in a low-income community; and (4) less than five percent of the average of the aggregate unadjusted bases of the property of the business is attributable to certain financial property or to certain collectibles.<sup>326</sup>

The maximum annual amount of qualified equity investments was \$3.5 billion for calendar years 2010, 2011, 2012, and 2013. The new markets tax credit expired on December 31, 2013. No amount of unused allocation limitation may be carried to any calendar year after 2018.

### ***Explanation of Provision***

The provision extends the new markets tax credit for one year, through 2014, permitting up to \$3.5 billion in qualified equity investments for the 2014 calendar year. The provision also extends for one year, through 2019, the carryover period for unused new markets tax credits.

<sup>323</sup> Sec. 45D(e)(2).

<sup>324</sup> Pub. L. No. 103–325.

<sup>325</sup> Pub. L. No. 103–325.

<sup>326</sup> Sec. 45D(d)(2).

*Effective Date*

The provision applies to calendar years beginning after December 31, 2013.

**6. Extension of railroad track maintenance credit (sec. 116 of the Act and sec. 45G of the Code)**

*Present Law*

Present law provides a 50-percent business tax credit for qualified railroad track maintenance expenditures paid or incurred by an eligible taxpayer during taxable years beginning before January 1, 2014.<sup>327</sup> The credit is limited to the product of \$3,500 times the number of miles of railroad track (1) owned or leased by an eligible taxpayer as of the close of its taxable year, and (2) assigned to the eligible taxpayer by a Class II or Class III railroad that owns or leases such track at the close of the taxable year.<sup>328</sup> Each mile of railroad track may be taken into account only once, either by the owner of such mile or by the owner's assignee, in computing the per-mile limitation. The credit also may reduce a taxpayer's tax liability below its tentative minimum tax.<sup>329</sup> Basis of the railroad track must be reduced (but not below zero) by an amount equal to 100 percent of the taxpayer's qualified railroad track maintenance tax credit determined for the taxable year.<sup>330</sup>

Qualified railroad track maintenance expenditures are defined as gross expenditures (whether or not otherwise chargeable to capital account) for maintaining railroad track (including roadbed, bridges, and related track structures) owned or leased as of January 1, 2005, by a Class II or Class III railroad (determined without regard to any consideration for such expenditure given by the Class II or Class III railroad which made the assignment of such track).<sup>331</sup>

An eligible taxpayer means any Class II or Class III railroad, and any person who transports property using the rail facilities of a Class II or Class III railroad or who furnishes railroad-related property or services to a Class II or Class III railroad, but only with respect to miles of railroad track assigned to such person by such railroad under the provision.<sup>332</sup>

The terms Class II or Class III railroad have the meanings given by the Surface Transportation Board.<sup>333</sup>

*Explanation of Provision*

The provision extends the present law credit for one year, for qualified railroad track maintenance expenditures paid or incurred in taxable years beginning after December 31, 2013, and before January 1, 2015.

<sup>327</sup> Sec. 45G(a) and (f).

<sup>328</sup> Sec. 45G(b)(1).

<sup>329</sup> Sec. 38(c)(4).

<sup>330</sup> Sec. 45G(e)(3).

<sup>331</sup> Sec. 45G(d).

<sup>332</sup> Sec. 45G(c).

<sup>333</sup> Sec. 45G(e)(1).

***Effective Date***

The provision is effective for expenditures paid or incurred in taxable years beginning after December 31, 2013.

**7. Extension of mine rescue team training credit (sec. 117 of the Act and sec. 45N of the Code)*****Present Law***

An eligible employer may claim a general business credit against income tax with respect to each qualified mine rescue team employee equal to the lesser of: (1) 20 percent of the amount paid or incurred by the taxpayer during the taxable year with respect to the training program costs of the qualified mine rescue team employee (including the wages of the employee while attending the program); or (2) \$10,000.<sup>334</sup> A qualified mine rescue team employee is any full-time employee of the taxpayer who is a miner eligible for more than six months of a taxable year to serve as a mine rescue team member by virtue of either having completed the initial 20 hour course of instruction prescribed by the Mine Safety and Health Administration's Office of Educational Policy and Development, or receiving at least 40 hours of refresher training in such instruction.<sup>335</sup>

An eligible employer is any taxpayer which employs individuals as miners in underground mines in the United States.<sup>336</sup> The term "wages" has the meaning given to such term by section 3306(b)<sup>337</sup> (determined without regard to any dollar limitation contained in that section).<sup>338</sup>

No deduction is allowed for the portion of the expenses otherwise deductible that is equal to the amount of the credit.<sup>339</sup> The credit does not apply to taxable years beginning after December 31, 2013.<sup>340</sup> Additionally, the credit is not allowable for purposes of computing the alternative minimum tax.<sup>341</sup>

***Explanation of Provision***

The provision extends the credit for one year through taxable years beginning on or before December 31, 2014.

***Effective Date***

The provision is effective for taxable years beginning after December 31, 2013.

---

<sup>334</sup> Sec. 45N(a).

<sup>335</sup> Sec. 45N(b).

<sup>336</sup> Sec. 45N(c).

<sup>337</sup> Section 3306(b) defines wages for purposes of Federal Unemployment Tax.

<sup>338</sup> Sec. 45N(d).

<sup>339</sup> Sec. 280C(e).

<sup>340</sup> Sec. 45N(e).

<sup>341</sup> Sec. 38(c).



**8. Extension of employer wage credit for employees who are active duty members of the uniformed services (sec. 118 of the Act and sec. 45P of the Code)**

***Present Law***

***Differential pay***

In general, compensation paid by an employer to an employee is deductible by the employer unless the expense must be capitalized.<sup>342</sup> In the case of an employee who is called to active duty with respect to the armed forces of the United States, some employers voluntarily pay the employee the difference between the compensation that the employer would have paid to the employee during the period of military service less the amount of pay received by the employee from the military. This payment by the employer is often referred to as “differential pay.”

***Wage credit for differential pay***

If an employer qualifies as an eligible small business employer, the employer is allowed a credit against its income tax liability for a taxable year in an amount equal to 20 percent of the sum of the eligible differential wage payments for each of the employer’s qualified employees during the year.

An eligible small business employer means, with respect to a taxable year, an employer that (1) employed on average less than 50 employees on business days during the taxable year, and (2) under a written plan of the taxpayer, provides eligible differential wage payments to every qualified employee. For this purpose, members of controlled groups, groups under common control, and affiliated service groups are treated as a single employer.<sup>343</sup> The credit is not available with respect to an employer that has failed to comply with the employment and reemployment rights of members of the uniformed services.<sup>344</sup>

Differential wage payment means any payment that (1) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services of the United States while on active duty for a period of more than 30 days, and (2) represents all or a portion of the wages that the individual would have received from the employer if the individual were performing services for the employer.<sup>345</sup> Eligible differential wage payments are so much of the differential wage payments paid to a qualified employee as does not exceed \$20,000. A qualified employee is an individual who has been an employee of the employer for the 91-day period immediately preceding the period for which any differential wage payment is made.

No deduction may be taken for that portion of compensation that is equal to the credit.<sup>346</sup> In addition, the amount of any other income tax credit otherwise allowable with respect to compensation paid to an employee must be reduced by the differential wage payment credit allowed with respect to the employee. The credit is not

<sup>342</sup> Sec. 162(a)(1).

<sup>343</sup> Sec. 414(b), (c), (m) and (o).

<sup>344</sup> Chapter 43 of Title 38 of the United States Code deals with these rights.

<sup>345</sup> Sec. 3401(h)(2).

<sup>346</sup> Sec. 280C(a).

allowable against a taxpayer's alternative minimum tax liability. Certain rules applicable to the work opportunity tax credit in the case of tax-exempt organizations, estates and trusts, and regulated investment companies, real estate investment trusts and certain cooperatives apply also to the differential wage payment credit.<sup>347</sup>

The credit is available with respect to amounts paid after June 17, 2008,<sup>348</sup> and before January 1, 2014.

### ***Explanation of Provision***

The provision extends the availability of the differential wage payment credit for one year to amounts paid before January 1, 2015.

### ***Effective Date***

The provision applies to payments made after December 31, 2013.

## **9. Extension of work opportunity tax credit (sec. 119 of the Act and secs. 51 and 52 of the Code)**

### ***Present Law***

#### ***In general***

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

#### ***Targeted groups eligible for the credit***

Generally, an employer is eligible for the credit only for qualified wages paid to members of a targeted group.

##### ***(1) Families receiving TANF***

An eligible recipient is an individual certified by a designated local employment agency (e.g., a State employment agency) as being a member of a family eligible to receive benefits under the Temporary Assistance for Needy Families Program ("TANF") for a period of at least nine months part of which is during the 18-month period ending on the hiring date. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for the TANF.

<sup>347</sup> Sec. 52(c), (d), (e).

<sup>348</sup> The credit was originally provided by the Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act"), Pub. L. No. 110-245, effective for amounts paid after June 17, 2008, the date of enactment of the HEART Act.

*(2) Qualified veteran*

Prior to enactment of the “VOW to Hire Heroes Act of 2011” (the “VOW Act”),<sup>349</sup> there were two subcategories of qualified veterans to whom wages paid by an employer were eligible for the credit. Employers who hired veterans who were eligible to receive assistance under a supplemental nutritional assistance program were entitled to a maximum credit of 40 percent of \$6,000 of qualified first-year wages paid to such individual.<sup>350</sup> Employers who hired veterans who were entitled to compensation for a service-connected disability were entitled to a maximum wage credit of 40 percent of \$12,000 of qualified first-year wages paid to such individual.<sup>351</sup>

The VOW Act modified the work opportunity credit with respect to qualified veterans, by adding additional subcategories. There are now five subcategories of qualified veterans: (1) in the case of veterans who were eligible to receive assistance under a supplemental nutritional assistance program (for at least a three month period during the year prior to the hiring date) the employer is entitled to a maximum credit of 40 percent of \$6,000 of qualified first-year wages; (2) in the case of a qualified veteran who is entitled to compensation for a service connected disability, who is hired within one year of discharge, the employer is entitled to a maximum credit of 40 percent of \$12,000 of qualified first-year wages; (3) in the case of a qualified veteran who is entitled to compensation for a service connected disability, and who has been unemployed for an aggregate of at least six months during the one year period ending on the hiring date, the employer is entitled to a maximum credit of 40 percent of \$24,000 of qualified first-year wages; (4) in the case of a qualified veteran unemployed for at least four weeks but less than six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of \$6,000 of qualified first-year wages; and (5) in the case of a qualified veteran unemployed for at least six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of \$14,000 of qualified first-year wages.

A veteran is an individual who has served on active duty (other than for training) in the Armed Forces for more than 180 days or who has been discharged or released from active duty in the Armed Forces for a service-connected disability. However, any individual who has served for a period of more than 90 days during which the individual was on active duty (other than for training) is not a qualified veteran if any of this active duty occurred during the 60-

<sup>349</sup> Pub. L. No. 112-56 (Nov. 21, 2011).

<sup>350</sup> For these purposes, a qualified veteran must be certified by the designated local agency as a member of a family receiving assistance under a supplemental nutrition assistance program under the Food and Nutrition Act of 2008 for a period of at least three months part of which is during the 12-month period ending on the hiring date. For these purposes, members of a family are defined to include only those individuals taken into account for purposes of determining eligibility for a supplemental nutrition assistance program under the Food and Nutrition Act of 2008.

<sup>351</sup> The qualified veteran must be certified as entitled to compensation for a service-connected disability and (1) have a hiring date which is not more than one year after having been discharged or released from active duty in the Armed Forces of the United States; or (2) have been unemployed for six months or more (whether or not consecutive) during the one-year period ending on the date of hiring. For these purposes, being entitled to compensation for a service-connected disability is defined with reference to section 101 of Title 38, U.S. Code, which means having a disability rating of 10 percent or higher for service connected injuries.

day period ending on the date the individual was hired by the employer. This latter rule is intended to prevent employers who hire current members of the armed services (or those departed from service within the last 60 days) from receiving the credit.

*(3) Qualified ex-felon*

A qualified ex-felon is an individual certified as: (1) having been convicted of a felony under any State or Federal law; and (2) having a hiring date within one year of release from prison or the date of conviction.

*(4) Designated community resident*

A designated community resident is an individual certified as being at least age 18 but not yet age 40 on the hiring date and as having a principal place of abode within an empowerment zone, enterprise community, renewal community or a rural renewal community. For these purposes, a rural renewal county is a county outside a metropolitan statistical area (as defined by the Office of Management and Budget) which had a net population loss during the five-year periods 1990–1994 and 1995–1999. Qualified wages do not include wages paid or incurred for services performed after the individual moves outside an empowerment zone, enterprise community, renewal community or a rural renewal community.

*(5) Vocational rehabilitation referral*

A vocational rehabilitation referral is an individual who is certified by a designated local agency as an individual who has a physical or mental disability that constitutes a substantial handicap to employment and who has been referred to the employer while receiving, or after completing: (a) vocational rehabilitation services under an individualized, written plan for employment under a State plan approved under the Rehabilitation Act of 1973; (b) under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code; or (c) an individual work plan developed and implemented by an employment network pursuant to subsection (g) of section 1148 of the Social Security Act. Certification will be provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

*(6) Qualified summer youth employee*

A qualified summer youth employee is an individual: (1) who performs services during any 90-day period between May 1 and September 15; (2) who is certified by the designated local agency as being 16 or 17 years of age on the hiring date; (3) who has not been an employee of that employer before; and (4) who is certified by the designated local agency as having a principal place of abode within an empowerment zone, enterprise community, or renewal community. As with designated community residents, no credit is available on wages paid or incurred for service performed after the qualified summer youth moves outside of an empowerment zone, enterprise community, or renewal community. If, after the end of the 90-day period, the employer continues to employ a youth who was certified during the 90-day period as a member of another tar-

geted group, the limit on qualified first-year wages will take into account wages paid to the youth while a qualified summer youth employee.

*(7) Qualified supplemental nutrition assistance program benefits recipient*

A qualified supplemental nutrition assistance program benefits recipient is an individual at least age 18 but not yet age 40 certified by a designated local employment agency as being a member of a family receiving assistance under a food and nutrition program under the Food and Nutrition Act of 2008 for a period of at least six months ending on the hiring date. In the case of families that cease to be eligible for food and nutrition assistance under section 6(o) of the Food and Nutrition Act of 2008, the six-month requirement is replaced with a requirement that the family has been receiving food and nutrition assistance for at least three of the five months ending on the date of hire. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for a food and nutrition assistance program under the Food and Nutrition Act of 2008.

*(8) Qualified SSI recipient*

A qualified SSI recipient is an individual designated by a local agency as receiving supplemental security income ("SSI") benefits under Title XVI of the Social Security Act for any month ending within the 60-day period ending on the hiring date.

*(9) Long-term family assistance recipient*

A qualified long-term family assistance recipient is an individual certified by a designated local agency as being: (1) a member of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) a member of a family that has received such family assistance for a total of at least 18 months (whether or not consecutive) after August 5, 1997 (the date of enactment of the welfare-to-work tax credit) if the individual is hired within two years after the date that the 18-month total is reached; or (3) a member of a family who is no longer eligible for family assistance because of either Federal or State time limits, if the individual is hired within two years after the Federal or State time limits made the family ineligible for family assistance.

**Qualified wages**

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit.

For purposes of the credit, generally, wages are defined by reference to the FUTA definition of wages contained in sec. 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

### ***Calculation of the credit***

The credit available to an employer for qualified wages paid to members of all targeted groups except for long-term family assistance recipients equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of \$6,000) attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is \$2,400 (40 percent of the first \$6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is \$1,200 (40 percent of the first \$3,000 of qualified first-year wages). Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of \$10,000 for qualified first-year wages and 50 percent of the first \$10,000 of qualified second-year wages. Generally, qualified second-year wages are qualified wages (not in excess of \$10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is \$9,000 (40 percent of the first \$10,000 of qualified first-year wages plus 50 percent of the first \$10,000 of qualified second-year wages).

For calculation of the credit with respect to qualified veterans, see the description of “qualified veteran” above.

### ***Certification rules***

Generally, an individual is not treated as a member of a targeted group unless: (1) on or before the day on which an individual begins work for an employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group; or (2) on or before the day an individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and not later than the 28th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. For these purposes, a pre-screening notice is a document (in such form as the Secretary may prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

An otherwise qualified unemployed veteran is treated as certified by the designated local agency as having aggregate periods of unemployment (whichever is applicable under the qualified veterans rules described above) if such veteran is certified by such agency as being in receipt of unemployment compensation under a State or Federal law for such applicable periods. The Secretary of the Treasury is authorized to provide alternative methods of certification for unemployed veterans.

***Minimum employment period***

No credit is allowed for qualified wages paid to employees who work less than 120 hours in the first year of employment.

***Qualified tax-exempt organizations employing qualified veterans***

The credit is not available to qualified tax-exempt organizations other than those employing qualified veterans. The special rules, described below, were enacted in the VOW Act.

If a qualified tax-exempt organization employs a qualified veteran (as described above) a tax credit against the FICA taxes of the organization is allowed on the wages of the qualified veteran which are paid for the veteran's services in furtherance of the activities related to the function or purpose constituting the basis of the organization's exemption under section 501.

The credit available to such tax-exempt employer for qualified wages paid to a qualified veteran equals 26 percent (16.25 percent for employment of 400 hours or less) of qualified first-year wages. The amount of qualified first-year wages eligible for the credit is the same as those for non-tax-exempt employers (*i.e.*, \$6,000, \$12,000, \$14,000 or \$24,000, depending on the category of qualified veteran).

A qualified tax-exempt organization means an employer that is described in section 501(c) and exempt from tax under section 501(a).

The Social Security Trust Funds are held harmless from the effects of this provision by a transfer from the Treasury General Fund.

***Treatment of possessions***

The VOW Act provided a reimbursement mechanism for the U.S. possessions (American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, and the United States Virgin Islands). The Treasury Secretary is to pay to each mirror code possession (Guam, the Commonwealth of the Northern Mariana Islands, and the United States Virgin Islands) an amount equal to the loss to that possession as a result of the VOW Act changes to the qualified veterans rules. Similarly, the Treasury Secretary is to pay to each non-mirror Code possession (American Samoa and the Commonwealth of Puerto Rico) the amount that the Secretary estimates as being equal to the loss to that possession that would have occurred as a result of the VOW Act changes if a mirror code tax system had been in effect in that possession. The Secretary will make this payment to a non-mirror Code possession only if that possession establishes to the satisfaction of the Secretary that the possession has implemented (or, at the discretion of the Secretary, will implement) an income tax benefit that is substantially equivalent to the qualified veterans credit allowed under the VOW Act modifications.

An employer that is allowed a credit against U.S. tax under the VOW Act with respect to a qualified veteran must reduce the amount of the credit claimed by the amount of any credit (or, in the case of a non-mirror Code possession, another tax benefit) that the employer claims against its possession income tax.

***Other rules***

The work opportunity tax credit is not allowed for wages paid to a relative or dependent of the taxpayer. No credit is allowed for wages paid to an individual who is a more than fifty-percent owner of the entity. Similarly, wages paid to replacement workers during a strike or lockout are not eligible for the work opportunity tax credit. Wages paid to any employee during any period for which the employer received on-the-job training program payments with respect to that employee are not eligible for the work opportunity tax credit. The work opportunity tax credit generally is not allowed for wages paid to individuals who had previously been employed by the employer. In addition, many other technical rules apply.

***Expiration***

The work opportunity tax credit is not available for individuals who begin work for an employer after December 31, 2013.

***Explanation of Provision***

The provision extends for one year the present-law employment credit provision (for individuals who begin work for the employer on or before December 31, 2014).

***Effective Date***

The provision is effective for individuals who begin work for the employer after December 31, 2013.

**10. Extension of qualified zone academy bonds (sec. 120 of the Act and sec. 54E of the Code)*****Present Law******Tax-exempt bonds***

Interest on State and local governmental bonds generally is excluded from gross income for Federal income tax purposes if the proceeds of the bonds are used to finance direct activities of these governmental units or if the bonds are repaid with revenues of the governmental units. These can include tax-exempt bonds which finance public schools.<sup>352</sup> An issuer must file with the Internal Revenue Service certain information about the bonds issued in order for that bond issue to be tax-exempt.<sup>353</sup> Generally, this information return is required to be filed no later than the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

The tax exemption for State and local bonds does not apply to any arbitrage bond.<sup>354</sup> An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.<sup>355</sup> In general, arbitrage profits may be

<sup>352</sup> Sec. 103.

<sup>353</sup> Sec. 149(e).

<sup>354</sup> Sec. 103(a) and (b)(2).

<sup>355</sup> Sec. 148.



earned only during specified periods (e.g., defined “temporary periods”) before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., “reasonably required reserve or replacement funds”). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal Government.

### ***Qualified zone academy bonds***

As an alternative to traditional tax-exempt bonds, States and local governments were given the authority to issue “qualified zone academy bonds.”<sup>356</sup> A total of \$400 million of qualified zone academy bonds is authorized to be issued annually in calendar years 1998 through 2008, \$1,400 million in 2009 and 2010, and \$400 million in 2011, 2012 and 2013. Each calendar year’s bond limitation is allocated to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the bond authority to qualified zone academies within such State.

A taxpayer holding a qualified zone academy bond on the credit allowance date is entitled to a credit. The credit is includible in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and alternative minimum tax liability.

Qualified zone academy bonds are a type of qualified tax credit bond and subject to the general rules applicable to qualified tax credit bonds.<sup>357</sup> The Treasury Department sets the credit rate at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer.<sup>358</sup> The Secretary determines credit rates for tax credit bonds based on general assumptions about credit quality of the class of potential eligible issuers and such other factors as the Secretary deems appropriate. The Secretary may determine credit rates based on general credit market yield indexes and credit ratings. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the principal on the bond is 50 percent of the face value of the bond.

“Qualified zone academy bonds” are defined as any bond issued by a State or local government, provided that (1) at least 100 percent of the available project proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a “qualified zone academy” and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A school is a “qualified zone academy” if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is

<sup>356</sup> See secs. 54E and 1397E.

<sup>357</sup> Sec. 54A.

<sup>358</sup> Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

located in an empowerment zone or enterprise community designated under the Code, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

Under section 6431 of the Code, an issuer of specified tax credit bonds, may elect to receive a payment in lieu of a credit being allowed to the holder of the bond (“direct-pay bonds”). The Code provides that section 6431 is not available for qualified zone academy bond allocations from the 2011 national limitation or any carry forward of the 2011 allocation.<sup>359</sup>

### ***Explanation of Provision***

The provision extends the qualified zone academy bond program for one year. The provision authorizes issuance of up to \$400 million of qualified zone academy bonds for 2014. The option to issue direct-pay bonds is not available for the 2014 bond limitation.

### ***Effective Date***

The provision generally applies to obligations issued after December 31, 2013.

## **11. Extension of classification of certain race horses as three-year property (sec. 121 of the Act and sec. 168 of the Code)**

### ***Present Law***

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization.<sup>360</sup> Tangible property generally is depreciated under the modified accelerated cost recovery system (“MACRS”), which determines depreciation by applying specific recovery periods,<sup>361</sup> placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.<sup>362</sup> In particular, the statute assigns a three-year recovery period for any race horse (1) that is placed in service after December 31, 2008 and before January 1, 2014<sup>363</sup> and (2) that is placed in service after December 31, 2013 and that is more than two years old at such time it is placed in service by the purchaser.<sup>364</sup> A

<sup>359</sup> Sec. 6431(f)(3)(A)(iii). Section 202(d) of the Act (described *infra*) contains a technical correction to provide that section 6431 is not available for any allocations from national limitation or carryforward for years 2011 and thereafter.

<sup>360</sup> See secs. 263(a) and 167.

<sup>361</sup> The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance. Exercising authority granted by Congress, the Secretary issued Rev. Proc. 87-56, 1987-2 C.B. 674, laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Rev. Proc. 88-22, 1988-1 C.B. 785. In November 1988, Congress revoked the Secretary’s authority to modify the class lives of depreciable property. Rev. Proc. 87-56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

<sup>362</sup> Sec. 168.

<sup>363</sup> Sec. 168(e)(3)(A)(i)(I), as in effect after amendment by the Food, Conservation and Energy Act of 2008, Pub. L. No. 110-246, sec. 15344(b).

<sup>364</sup> Sec. 168(e)(3)(A)(i)(II). A horse is more than 2 years old after the day that is 24 months after its actual birthdate. Rev. Proc. 87-56, 1987-2 C.B. 674, as clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785.

seven-year recovery period is assigned to any race horse that is placed in service after December 31, 2013 and that is two years old or younger at the time it is placed in service.<sup>365</sup>

### ***Explanation of Provision***

The provision extends the present-law three-year recovery period for race horses for one year to apply to any race horse (regardless of age when placed in service) which is placed in service before January 1, 2015. Subsequently, the three-year recovery period for race horses will only apply to those which are more than two years old when placed in service by the purchaser after December 31, 2014.

### ***Effective Date***

The provision applies to property placed in service after December 31, 2013.

## **12. Extension of 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements (sec. 122 of the Act and sec. 168 of the Code)**

### ***Present Law***

#### ***In general***

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.<sup>366</sup> The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39 years. Nonresidential real property is subject to the mid-month placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year in which property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month.

#### ***Depreciation of leasehold improvements***

Generally, depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease. This rule applies regardless of whether the lessor or the lessee places the leasehold improvements in service. If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement generally is depreciated using the straight-line method over a 39-

<sup>365</sup> Rev. Proc. 87-56, 1987-2 C.B. 674, asset class 01.225.

<sup>366</sup> Sec. 168.

year recovery period, beginning in the month the addition or improvement was placed in service. However, exceptions exist for certain qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property.

### ***Qualified leasehold improvement property***

Section 168(e)(3)(E)(iv) provides a statutory 15-year recovery period for qualified leasehold improvement property placed in service before January 1, 2014. Qualified leasehold improvement property is any improvement to an interior portion of a building that is non-residential real property, provided certain requirements are met.<sup>367</sup> The improvement must be made under or pursuant to a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.<sup>368</sup> If a lessor makes an improvement that qualifies as qualified leasehold improvement property, such improvement does not qualify as qualified leasehold improvement property to any subsequent owner of such improvement.<sup>369</sup> An exception to the rule applies in the case of death and certain transfers of property that qualify for non-recognition treatment.<sup>370</sup>

Qualified leasehold improvement property is generally recovered using the straight-line method and a half-year convention.<sup>371</sup> Qualified leasehold improvement property placed in service after December 31, 2013 is subject to the general rules described above.

### ***Qualified restaurant property***

Section 168(e)(3)(E)(v) provides a statutory 15-year recovery period for qualified restaurant property placed in service before January 1, 2014. Qualified restaurant property is any section 1250 property that is a building or an improvement to a building, if more than 50 percent of the building's square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals.<sup>372</sup> Qualified restaurant property is recovered using the straight-line method and a half-year convention.<sup>373</sup> Additionally, qualified restaurant property is not eligible for bonus depreciation.<sup>374</sup> Qualified restaurant property placed in service after December 31, 2013 is subject to the general rules described above.

<sup>367</sup> Sec. 168(e)(6).

<sup>368</sup> Sec. 168(e)(6) and (k)(3).

<sup>369</sup> Sec. 168(e)(6)(A).

<sup>370</sup> Sec. 168(e)(6)(B).

<sup>371</sup> Sec. 168(b)(3)(G) and (d).

<sup>372</sup> Sec. 168(e)(7).

<sup>373</sup> Sec. 168(b)(3)(H) and (d).

<sup>374</sup> Sec. 168(e)(7)(B). Property that satisfies the definition of both qualified leasehold improvement property and qualified restaurant property is eligible for bonus depreciation. Sec. 3.03(3) of Rev. Proc. 2011-26, 2011-16 I.R.B. 664, 2011.

### ***Qualified retail improvement property***

Section 168(e)(3)(E)(ix) provides a statutory 15-year recovery period for qualified retail improvement property placed in service before January 1, 2014. Qualified retail improvement property is any improvement to an interior portion of a building which is nonresidential real property if such portion is open to the general public<sup>375</sup> and is used in the retail trade or business of selling tangible personal property to the general public, and such improvement is placed in service more than three years after the date the building was first placed in service.<sup>376</sup> Qualified retail improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.<sup>377</sup> In the case of an improvement made by the owner of such improvement, the improvement is a qualified retail improvement only so long as the improvement is held by such owner.<sup>378</sup>

Retail establishments that qualify for the 15-year recovery period include those primarily engaged in the sale of goods. Examples of these retail establishments include, but are not limited to, grocery stores, clothing stores, hardware stores, and convenience stores. Establishments primarily engaged in providing services, such as professional services, financial services, personal services, health services, and entertainment, do not qualify. Generally, it is intended that businesses defined as a store retailer under the current North American Industry Classification System (industry sub-sectors 441 through 453) qualify while those in other industry classes do not qualify.

Qualified retail improvement property is recovered using the straight-line method and a half-year convention.<sup>379</sup> Additionally, qualified retail improvement property is not eligible for bonus depreciation.<sup>380</sup> Qualified retail improvement property placed in service after December 31, 2013 is subject to the general rules described above.

### ***Explanation of Provision***

The provision extends the present-law provisions for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property for one year to apply to property placed in service before January 1, 2015.

### ***Effective Date***

The provision is effective for property placed in service after December 31, 2013.

<sup>375</sup> Improvements to portions of a building not open to the general public (e.g., stock room in back of retail space) do not qualify under the provision.

<sup>376</sup> Sec. 168(e)(8).

<sup>377</sup> Sec. 168(e)(8)(C).

<sup>378</sup> Sec. 168(e)(8)(B).

<sup>379</sup> Sec. 168(b)(3)(I) and (d).

<sup>380</sup> Sec. 168(e)(8)(D). Property that satisfies the definition of both qualified leasehold improvement property and qualified retail improvement property is eligible for bonus depreciation. Sec. 3.03(3) of Rev. Proc. 2011-26, 2011-16 I.R.B. 664, 2011.

### 13. Extension of seven-year recovery period for motorsports entertainment complexes (sec. 123 of the Act and sec. 168 of the Code)

#### *Present Law*

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization.<sup>381</sup> Tangible property generally is depreciated under the modified accelerated cost recovery system (“MACRS”), which determines depreciation by applying specific recovery periods,<sup>382</sup> placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.<sup>383</sup> The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39 years.<sup>384</sup> Nonresidential real property is subject to the mid-month convention, which treats all property placed in service during any month (or disposed of during any month) as placed in service (or disposed of) on the mid-point of such month.<sup>385</sup> All other property generally is subject to the half-year convention, which treats all property placed in service during any taxable year (or disposed of during any taxable year) as placed in service (or disposed of) on the mid-point of such taxable year.<sup>386</sup> Land improvements (such as roads and fences) are recovered using the 150-percent declining balance method and a recovery period of 15-years.<sup>387</sup> An exception exists for the theme and amusement park industry, whose assets are assigned a recovery period of seven years.<sup>388</sup> Additionally, a motorsports entertainment complex placed in service on or before December 31, 2013 is assigned a recovery period of seven years.<sup>389</sup> For these purposes, a motorsports entertainment complex means a racing track facility which is permanently situated on land and which during the 36-month period following its placed-in-service date hosts a racing event.<sup>390</sup> The term motorsports entertainment complex also includes ancillary facilities, land improvements (*e.g.*, parking lots, sidewalks, fences), support facilities (*e.g.*, food and

<sup>381</sup> See secs. 263(a) and 167.

<sup>382</sup> The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance. Exercising authority granted by Congress, the Secretary issued Rev. Proc. 87-56, 1987-2 C.B. 674, laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Rev. Proc. 88-22, 1988-1 C.B. 785. In November 1988, Congress revoked the Secretary’s authority to modify the class lives of depreciable property. Rev. Proc. 87-56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

<sup>383</sup> Sec. 168.

<sup>384</sup> Sec. 168(b)(3)(A) and 168(c).

<sup>385</sup> Sec. 168(d)(2)(A) and (d)(4)(B).

<sup>386</sup> Sec. 168(d)(1) and (d)(4)(A). However, if substantial property is placed in service during the last three months of a taxable year, a special rule requires use of the mid-quarter convention, which treats all property placed in service (or disposed of) during any quarter as placed in service (or disposed of) on the mid-point of such quarter. Secs. 168(d)(3) and (d)(4)(C).

<sup>387</sup> Sec. 168(b)(2)(A) and asset class 00.3 of Rev. Proc. 87-56, 1987-2 C.B. 674, 1987. Under the 150-percent declining balance method, the depreciation rate is determined by dividing 150-percent by the appropriate recovery period, switching to the straight-line method for the first taxable year where using the straight-line method with respect to the adjusted basis as of the beginning of that year will yield a larger depreciation allowance. Sec. 168(b)(2) and (b)(1)(B).

<sup>388</sup> Asset class 80.0 of Rev. Proc. 87-56, 1987-2 C.B. 674, 1987.

<sup>389</sup> Sec. 168(e)(3)(C)(ii).

<sup>390</sup> Sec. 168(i)(15).

beverage retailing, souvenir vending), and appurtenances associated with such facilities (e.g., ticket booths, grandstands).

### ***Explanation of Provision***

The provision extends the present-law seven-year recovery period for motorsports entertainment complexes for one year to apply to property placed in service on or before December 31, 2014.

### ***Effective Date***

The provision is effective for property placed in service after December 31, 2013.

## **14. Extension of accelerated depreciation for business property on an Indian reservation (sec. 124 of the Act and sec. 168(j) of the Code)**

### ***Present Law***

With respect to certain property used in connection with the conduct of a trade or business within an Indian reservation, depreciation deductions under section 168(j) are determined using the following recovery periods:

3-year property .....	2 years
5-year property .....	3 years
7-year property .....	4 years
10-year property .....	6 years
15-year property .....	9 years
20-year property .....	12 years
Nonresidential real property .....	22 years <sup>391</sup>

“Qualified Indian reservation property” eligible for accelerated depreciation includes property described in the table above which is: (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation; (2) not used or located outside the reservation on a regular basis; (3) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer;<sup>392</sup> and (4) is not property placed in service for purposes of conducting gaming activities.<sup>393</sup> Certain “qualified infrastructure property” may be eligible for the accelerated depreciation even if located outside an Indian reservation, provided that the purpose of such property is to connect with qualified infrastructure property located within the reservation (e.g., roads, power lines, water systems, railroad spurs, and communications facilities).<sup>394</sup>

An “Indian reservation” means a reservation as defined in section 3(d) of the Indian Financing Act of 1974 (25 U.S.C. 1452(d))<sup>395</sup> or section 4(10) of the Indian Child Welfare Act of 1978 (25 U.S.C. 1903(10)).<sup>396</sup> For purposes of the preceding sentence, section 3(d) is applied by treating “former Indian reservations in Oklahoma” as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the

<sup>391</sup> Section 168(j)(2) does not provide shorter recovery periods for water utility property, residential rental property, or railroad grading and tunnel bores.

<sup>392</sup> For these purposes, the term “related persons” is defined in section 465(b)(3)(C).

<sup>393</sup> Sec. 168(j)(4)(A).

<sup>394</sup> Sec. 168(j)(4)(C).

<sup>395</sup> Pub. L. No. 93–262.

<sup>396</sup> Pub. L. No. 95–608.

Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).<sup>397</sup>

The depreciation deduction allowed for regular tax purposes is also allowed for purposes of the alternative minimum tax.<sup>398</sup> The accelerated depreciation for qualified Indian reservation property is available with respect to property placed in service on or before December 31, 2013.<sup>399</sup>

### ***Explanation of Provision***

The provision extends for one year the present-law accelerated depreciation for qualified Indian reservation property to apply to property placed in service on or before December 31, 2014.

### ***Effective Date***

The provision is effective for property placed in service after December 31, 2013.

## **15. Extension of bonus depreciation (sec. 125 of the Act and sec. 168(k) of the Code)**

### ***Present Law***

#### ***In general***

An additional first-year depreciation deduction is allowed equal to 50 percent of the adjusted basis of qualified property acquired and placed in service after December 31, 2007 and before January 1, 2014 (January 1, 2015 for certain longer-lived and transportation property).<sup>400</sup>

The additional first-year depreciation deduction is allowed for both the regular tax and the alternative minimum tax (“AMT”),<sup>401</sup> but is not allowed in computing earnings and profits.<sup>402</sup> The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction.<sup>403</sup> The amount of the additional first-year depreciation deduction is not affected by a short taxable year.<sup>404</sup> The taxpayer may elect out of additional first-year depreciation for any class of property for any taxable year.<sup>405</sup>

The interaction of the additional first-year depreciation allowance with the otherwise applicable depreciation allowance may be illustrated as follows. Assume that in 2013, a taxpayer purchased

<sup>397</sup> Sec. 168(j)(6).

<sup>398</sup> Sec. 168(j)(3).

<sup>399</sup> Sec. 168(j)(8).

<sup>400</sup> Sec. 168(k). The additional first-year depreciation deduction is subject to the general rules regarding whether an item must be capitalized under section 263A. An additional first-year depreciation deduction is allowed equal to 100 percent of the adjusted basis of qualified original-use property if it meets the requirements for the additional first-year depreciation and the taxpayer acquired and placed the property in service after September 8, 2010 and before January 1, 2012 (January 1, 2013 for certain longer-lived and transportation property). Sec. 168(k)(5). See also Rev. Proc. 2011–26, 2011–16 I.R.B. 664, 2011.

<sup>401</sup> Sec. 168(k)(2)(G). See also Treas. Reg. sec. 1.168(k)–1(d).

<sup>402</sup> Treas. Reg. sec. 1.168(k)–1(f)(7).

<sup>403</sup> Sec. 168(k)(1)(B).

<sup>404</sup> *Ibid.*

<sup>405</sup> Sec. 168(k)(2)(D)(iii). For the definition of a class of property, see Treas. Reg. sec. 1.168(k)–1(e)(2).



new depreciable property and placed it in service.<sup>406</sup> The property's cost is \$1,000, and it is five-year property subject to the 200 percent declining balance method and half-year convention. The amount of additional first-year depreciation allowed is \$500. The remaining \$500 of the cost of the property is depreciable under the rules applicable to five-year property. Thus \$100<sup>407</sup> also is allowed as a depreciation deduction in 2013. The total depreciation deduction with respect to the property for 2013 is \$600. The remaining \$400 adjusted basis of the property generally is recovered through otherwise applicable depreciation rules.

Property qualifying for the additional first-year depreciation deduction must meet all of the following requirements. First, the property must be (1) property to which the modified accelerated cost recovery system ("MACRS") applies with an applicable recovery period of 20 years or less; (2) water utility property (as defined in section 168(e)(5)); (3) computer software other than computer software covered by section 197; or (4) qualified leasehold improvement property (as defined in section 168(k)(3)).<sup>408</sup> Second, the original use<sup>409</sup> of the property must commence with the taxpayer after December 31, 2007.<sup>410</sup> Third, the taxpayer must acquire the property within the applicable time period (as described below). Finally, the property must be placed in service before January 1, 2014. An extension of the placed-in-service date of one year (*i.e.*, before January 1, 2015) is provided for certain property with a recovery period of 10 years or longer and certain transportation property.<sup>411</sup>

To qualify, property must be acquired (1) after December 31, 2007, and before January 1, 2014, but only if no binding written contract for the acquisition is in effect before January 1, 2008, or (2) pursuant to a binding written contract which was entered into

<sup>406</sup> Assume that the cost of the property is not eligible for expensing under section 179.

<sup>407</sup> \$100 results from the application of the half-year convention and the 200 percent declining balance method to the remaining \$500.

<sup>408</sup> The additional first-year depreciation deduction is not available for any property that is required to be depreciated under the alternative depreciation system of MACRS. Sec. 168(k)(2)(D)(i). The additional first-year depreciation deduction also is not available for qualified New York Liberty Zone leasehold improvement property as defined in section 1400L(c)(2). Sec. 168(k)(2)(D)(ii).

<sup>409</sup> The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (*i.e.*, each fractional owner is considered the original user of its proportionate share of the property). Treas. Reg. sec. 1.168(k)-1(b)(3).

<sup>410</sup> A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback. If property is originally placed in service by a lessor, such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale. Sec. 168(k)(2)(E)(ii).

<sup>411</sup> Property qualifying for the extended placed-in-service date must have an estimated production period exceeding one year and a cost exceeding \$1 million. Transportation property generally is defined as tangible personal property used in the trade or business of transporting persons or property. Certain aircraft which is not transportation property, other than for agricultural or firefighting uses, also qualifies for the extended placed-in-service-date, if at the time of the contract for purchase, the purchaser made a nonrefundable deposit of the lesser of 10 percent of the cost or \$100,000, and which has an estimated production period exceeding four months and a cost exceeding \$200,000.

after December 31, 2007, and before January 1, 2014.<sup>412</sup> With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property after December 31, 2007, and before January 1, 2014.<sup>413</sup> Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.<sup>414</sup> For property eligible for the extended placed-in-service date, a special rule limits the amount of costs eligible for the additional first-year depreciation. With respect to such property, only the portion of the basis that is properly attributable to the costs incurred before January 1, 2014 (“progress expenditures”) is eligible for the additional first-year depreciation deduction.<sup>415</sup>

Property does not qualify for the additional first-year depreciation deduction when the user of such property (or a related party) would not have been eligible for the additional first-year depreciation deduction if the user (or a related party) were treated as the owner.<sup>416</sup> For example, if a taxpayer sells to a related party property that was under construction prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. Similarly, if a taxpayer sells to a related party property that was subject to a binding written contract prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. As a further example, if a taxpayer (the lessee) sells property in a sale-leaseback arrangement, and the property otherwise would not have qualified for the additional first-year depreciation deduction if it were owned by the taxpayer-lessee, then the lessor is not entitled to the additional first-year depreciation deduction.

The limitation under section 280F on the amount of depreciation deductions allowed with respect to certain passenger automobiles is increased in the first year by \$8,000 for automobiles that qualify (and for which the taxpayer does not elect out of the additional first-year deduction).<sup>417</sup> The \$8,000 amount is not indexed for inflation.

### ***Special rule for long-term contracts***

In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method.<sup>418</sup> Solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of seven years or less is

<sup>412</sup>In the case of a binding written contract to acquire one or more components of a larger self-constructed asset, the larger self-constructed asset will not fail to qualify for the additional first-year depreciation merely because a binding written contract to acquire one or more components of such property was in effect prior to January 1, 2008. See Treas. Reg. sec. 1.168(k)-1(b)(4)(iii)(C). See also, Treas. Reg. sec. 1.168(k)-1(b)(4)(v), Examples 6 and 7.

<sup>413</sup>Sec. 168(k)(2)(E)(i).

<sup>414</sup>Treas. Reg. sec. 1.168(k)-1(b)(4)(iii).

<sup>415</sup>Sec. 168(k)(2)(B)(ii). For purposes of determining the amount of eligible progress expenditures, rules similar to section 46(d)(3) as in effect prior to the Tax Reform Act of 1986 apply.

<sup>416</sup>Sec. 168(k)(2)(E)(iv).

<sup>417</sup>Sec. 168(k)(2)(F).

<sup>418</sup>See sec. 460.

taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted for property placed in service (1) after December 31, 2009 and before January 1, 2011 (January 1, 2012 in the case of certain longer-lived and transportation property) or (2) after December 31, 2012 and before January 1, 2014 (January 1, 2015 in the case of certain longer-lived and transportation property).<sup>419</sup> Bonus depreciation generally is taken into account in determining taxable income under the percentage-of-completion method for property placed in service after December 31, 2010 and before January 1, 2013.

***Election to accelerate AMT credits in lieu of bonus depreciation***

A corporation otherwise eligible for additional first-year depreciation may elect to claim additional AMT credits in lieu of claiming additional depreciation with respect to “eligible qualified property.”<sup>420</sup> In the case of a corporation making this election, the straight line method is used for the regular tax and the AMT with respect to eligible qualified property.<sup>421</sup>

Generally, an election under this provision for a taxable year applies to subsequent taxable years. However, each time the provision has been extended, a corporation which has previously made an election has been allowed to elect not to claim additional minimum tax credits, or, if no election had previously been made, to make an election to claim additional credits with respect to property subject to the extension.<sup>422</sup>

A corporation making an election increases the tax liability limitation under section 53(c) on the use of minimum tax credits by the bonus depreciation amount.<sup>423</sup> The aggregate increase in credits allowable by reason of the increased limitation is treated as refundable.<sup>424</sup>

The bonus depreciation amount generally is equal to 20 percent of bonus depreciation<sup>425</sup> for eligible qualified property that could be claimed as a deduction absent an election under this provision. As originally enacted, the bonus depreciation amount for all taxable years was limited to the lesser of (1) \$30 million, or (2) six percent of the minimum tax credits allocable to the adjusted net minimum tax imposed for taxable years beginning before January 1, 2006.<sup>426</sup> However, extensions of this provision have provided that this limitation applies separately to property subject to each extension.

<sup>419</sup> Sec. 460(c)(6).

<sup>420</sup> Sec. 168(k)(4). Eligible qualified property means qualified property eligible for bonus depreciation with minor effective date differences having little (if any) remaining significance.

<sup>421</sup> Sec. 168(k)(4)(A).

<sup>422</sup> Secs. 168(k)(4)(H), (I), and (J).

<sup>423</sup> Sec. 168(k)(4)(B)(ii).

<sup>424</sup> Sec. 168(k)(4)(F).

<sup>425</sup> For this purpose, bonus depreciation is the difference between (i) the aggregate amount of depreciation determined if section 168(k)(1) applied to all eligible qualified property placed in service during the taxable year and (ii) the amount of depreciation that would be so determined if section 168(k)(1) did not so apply. This determination is made using the most accelerated depreciation method and the shortest life otherwise allowable for each property. Sec. 168(k)(4)(C).

<sup>426</sup> Sec. 168(k)(4)(C)(iii).

All corporations treated as a single employer under section 52(a) are treated as one taxpayer for purposes of the limitation, as well as for electing the application of this provision.<sup>427</sup>

In the case of a corporation making an election which is a partner in a partnership, for purposes of determining the electing partner's distributive share of partnership items, bonus depreciation does not apply to any eligible qualified property and the straight line method is used with respect to that property.<sup>428</sup>

### ***Explanation of Provision***

The provision extends the 50-percent additional first-year depreciation deduction for one year, generally through 2014 (through 2015 for certain longer-lived and transportation property).

The provision provides that solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of seven years or less which is placed in service after December 31, 2012 and before January 1, 2015 (January 1, 2016, in the case of certain longer-lived and transportation property) is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted.

The provision also extends the election to increase the AMT credit limitation in lieu of bonus depreciation for one year to property placed in service before January 1, 2015 (January 1, 2016, in the case of certain longer-lived property and transportation property). A bonus depreciation amount, maximum amount, and maximum increase amount is computed separately with respect to property to which the extension of additional first-year depreciation applies ("round 4 extension property").<sup>429</sup>

Under the provision, a corporation that has an election in effect with respect to round 3 extension property to claim minimum tax credits in lieu of bonus depreciation is treated as having an election in effect for round 4 extension property, unless the corporation elects otherwise. The provision also allows a corporation that does not have an election in effect with respect to round 3 extension property to elect to claim minimum tax credits in lieu of bonus depreciation for round 4 extension property. A separate bonus depreciation amount, maximum amount, and maximum increase amount is computed and applied to round 4 extension property.<sup>430</sup>

### ***Effective Date***

The provision is effective for property placed in service after December 31, 2013, in taxable years ending after such date.

<sup>427</sup> Sec. 168(k)(4)(C)(iv).

<sup>428</sup> Sec. 168(k)(4)(G)(ii).

<sup>429</sup> An election with respect to round 4 extension property is binding for all property that is eligible qualified property solely by reason of the extension of the 50-percent additional first-year depreciation deduction.

<sup>430</sup> In computing the maximum amount, the maximum increase amount for round 4 extension property is reduced by bonus depreciation amounts for preceding taxable years only with respect to round 4 extension property.

**16. Extension of enhanced charitable deduction for contributions of food inventory (sec. 126 of the Act and sec. 170 of the Code)**

***Present Law***

***Charitable contributions in general***

In general, an income tax deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization.<sup>431</sup>

Charitable contributions of cash are deductible in the amount contributed. In general, contributions of capital gain property are deductible at fair market value with certain exceptions. Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of other appreciated property generally are deductible at the donor's basis in the property. Contributions of depreciated property generally are deductible at the fair market value of the property.

***General rules regarding contributions of inventory***

Under present law, a taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory, or if less the fair market value of the inventory.

For certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis) or (2) two times basis.<sup>432</sup> In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income.<sup>433</sup> To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer and must be contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants; (2) not transfer the property in exchange for money, other property, or services; and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements.<sup>434</sup> In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, as amended, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer.<sup>435</sup>

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market

<sup>431</sup> Sec. 170.

<sup>432</sup> Sec. 170(e)(3).

<sup>433</sup> Sec. 170(b)(2).

<sup>434</sup> Sec. 170(e)(3)(A)(i)-(iii).

<sup>435</sup> Sec. 170(e)(3)(A)(iv).

value of the property or the donor's basis with respect to the inventory.<sup>436</sup>

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of disputes between taxpayers and the IRS.<sup>437</sup>

***Temporary rule expanding and modifying the enhanced deduction for contributions of food inventory***

Under a temporary provision, any taxpayer engaged in a trade or business, whether or not a C corporation, is eligible to claim the enhanced deduction for donations of food inventory.<sup>438</sup> For taxpayers other than C corporations, the total deduction for donations of food inventory in a taxable year generally may not exceed 10 percent of the taxpayer's net income for such taxable year from all sole proprietorships, S corporations, or partnerships (or other non C corporations) from which contributions of apparently wholesome food are made. For example, if a taxpayer is a sole proprietor, a shareholder in an S corporation, and a partner in a partnership, and each business makes charitable contributions of food inventory, the taxpayer's deduction for donations of food inventory is limited to 10 percent of the taxpayer's net income from the sole proprietorship and the taxpayer's interests in the S corporation and partnership. However, if only the sole proprietorship and the S corporation made charitable contributions of food inventory, the taxpayer's deduction would be limited to 10 percent of the net income from the trade or business of the sole proprietorship and the taxpayer's interest in the S corporation, but not the taxpayer's interest in the partnership.<sup>439</sup>

Under the temporary provision, the enhanced deduction for food is available only for food that qualifies as "apparently wholesome food." Apparently wholesome food is defined as food intended for human consumption that meets all quality and labeling standards imposed by Federal, State, and local laws and regulations even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions.

The provision does not apply to contributions made after December 31, 2013.

***Explanation of Provision***

The provision extends the special rule for charitable contributions of food inventory to contributions made before January 1, 2015.

<sup>436</sup>Treas. Reg. sec. 1.170A-4A(c)(3).

<sup>437</sup>*Lucky Stores Inc. v. Commissioner*, 105 T.C. 420 (1995) (holding that the value of surplus bread inventory donated to charity was the full retail price of the bread rather than half the retail price, as the IRS asserted).

<sup>438</sup>Sec. 170(e)(3)(C).

<sup>439</sup>The 10 percent limitation does not affect the application of the generally applicable percentage limitations. For example, if 10 percent of a sole proprietor's net income from the proprietor's trade or business was greater than 50 percent of the proprietor's contribution base, the available deduction for the taxable year (with respect to contributions to public charities) would be 50 percent of the proprietor's contribution base. Consistent with present law, such contributions may be carried forward because they exceed the 50 percent limitation. Contributions of food inventory by a taxpayer that is not a C corporation that exceed the 10 percent limitation but not the 50 percent limitation could not be carried forward.

### *Effective Date*

The provision is effective for contributions made after December 31, 2013.

## **17. Extension of increased expensing limitations and treatment of certain real property as section 179 property (sec. 127 of the Act and sec. 179 of the Code)**

### *Present Law*

A taxpayer may elect under section 179 to deduct (or “expense”) the cost of qualifying property, rather than to recover such costs through depreciation deductions, subject to limitation.<sup>440</sup> For taxable years beginning in 2013, the maximum amount a taxpayer may expense is \$500,000 of the cost of qualifying property placed in service for the taxable year.<sup>441</sup> The \$500,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$2,000,000.<sup>442</sup> The \$500,000 and \$2,000,000 amounts are not indexed for inflation. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business.<sup>443</sup> For taxable years beginning before 2014, qualifying property also includes off-the-shelf computer software and qualified real property (i.e., qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).<sup>444</sup> Of the \$500,000 expense amount available under section 179, the maximum amount available with respect to qualified real property is \$250,000 for each taxable year.<sup>445</sup>

For taxable years beginning in 2014 and thereafter, a taxpayer may elect to deduct up to \$25,000 of the cost of qualifying property placed in service for the taxable year, subject to limitation. The \$25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$200,000. The \$25,000 and \$200,000 amounts are not indexed for inflation. In general, qualifying property is defined as depreciable tangible personal property (not including off-the-shelf computer software or qualified real property) that is purchased for use in the active conduct of a trade or business.

<sup>440</sup> Additional section 179 incentives have been provided with respect to qualified property meeting applicable requirements that is used by a business in an enterprise zone (sec. 1397A), a renewal community (sec. 1400J), the New York Liberty Zone (sec. 1400L(f)), or the Gulf Opportunity Zone (sec. 1400N(e)). In addition, section 179(e) provides for an enhanced section 179 deduction for qualified disaster assistance property.

<sup>441</sup> For the years 2003 through 2006, the relevant dollar amount is \$100,000 (indexed for inflation); in 2007, the dollar limitation is \$125,000; for the 2008 and 2009 years, the relevant dollar amount is \$250,000; and for 2010, 2011, and 2012, the relevant dollar limitation is \$500,000. Sec. 179(b)(1).

<sup>442</sup> For the years 2003 through 2006, the relevant dollar amount is \$400,000 (indexed for inflation); in 2007, the dollar limitation is \$500,000; for the 2008 and 2009 years, the relevant dollar amount is \$800,000; and for 2010, 2011, and 2012, the relevant dollar limitation is \$2,000,000. Sec. 179(b)(2).

<sup>443</sup> Qualifying property does not include any property described in section 50(b), air conditioning units, or heating units. Sec. 179(d)(1). Passenger automobiles subject to the section 280F limitation are eligible for section 179 expensing only to the extent of the dollar limitations in section 280F. For sport utility vehicles above the 6,000 pound weight rating, which are not subject to the limitation under section 280F, the maximum cost that may be expensed for any taxable year under section 179 is \$25,000. Sec. 179(b)(5).

<sup>444</sup> Secs. 179(d)(1)(A)(ii) and (f).

<sup>445</sup> Sec. 179(f)(3).

The amount eligible to be expensed for a taxable year may not exceed the taxable income for such taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision).<sup>446</sup> Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to limitations). However, amounts attributable to qualified real property that are disallowed under the trade or business income limitation may only be carried over to taxable years in which the definition of eligible section 179 property includes qualified real property.<sup>447</sup> Thus, if a taxpayer's section 179 deduction for 2012 with respect to qualified real property is limited by the taxpayer's active trade or business income, such disallowed amount may be carried over to 2013. Any such carryover amounts that are not used in 2013 are treated as property placed in service in 2013 for purposes of computing depreciation. That is, the unused carryover amount from 2012 is considered placed in service on the first day of the 2013 taxable year.<sup>448</sup>

No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179.<sup>449</sup> If a corporation makes an election under section 179 to deduct expenditures, the full amount of the deduction does not reduce earnings and profits. Rather, the expenditures that are deducted reduce corporate earnings and profits ratably over a five-year period.<sup>450</sup>

An expensing election is made under rules prescribed by the Secretary.<sup>451</sup> In general, any election or specification made with respect to any property may not be revoked except with the consent of the Commissioner. However, an election or specification under section 179 may be revoked by the taxpayer without consent of the Commissioner for taxable years beginning after 2002 and before 2014.<sup>452</sup>

### ***Explanation of Provision***

The provision provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2014, is \$500,000 of the cost of qualifying property placed in service for the taxable year. The \$500,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$2,000,000.

In addition, the provision extends, for taxable years beginning in 2014, the treatment of off-the-shelf computer software as qualifying

<sup>446</sup> Sec. 179(b)(3).

<sup>447</sup> Section 179(f)(4) details the special rules that apply to disallowed amounts.

<sup>448</sup> For example, assume that during 2012, a company's only asset purchases are section 179-eligible equipment costing \$100,000 and qualifying leasehold improvements costing \$200,000. Assume the company has no other asset purchases during 2012, and has a taxable income limitation of \$150,000. The maximum section 179 deduction the company can claim for 2012 is \$150,000, which is allocated pro rata between the properties, such that the carryover to 2013 is allocated \$100,000 to the qualified leasehold improvements and \$50,000 to the equipment.

Assume further that in 2013, the company had no asset purchases and had no taxable income. The \$100,000 carryover from 2012 attributable to qualified leasehold improvements is treated as placed in service as of the first day of the company's 2013 taxable year. The \$50,000 carryover allocated to equipment is carried over to 2013 under section 179(b)(3)(B).

<sup>449</sup> Sec. 179(d)(9).

<sup>450</sup> Sec. 312(k)(3)(B).

<sup>451</sup> Sec. 179(c)(1).

<sup>452</sup> Sec. 179(c)(2).



property. The provision also extends the treatment of qualified real property as eligible section 179 property for taxable years beginning in 2014, including the limitation on carryovers and the maximum amount available with respect to qualified real property of \$250,000 for each taxable year. For taxable years beginning in 2014, the provision continues to permit a taxpayer to amend or irrevocably revoke an election for a taxable year under section 179 without the consent of the Commissioner.

### ***Effective Date***

The provision applies to taxable years beginning after December 31, 2013.

## **18. Extension of election to expense mine safety equipment (sec. 128 of the Act and sec. 179E of the Code)**

### ***Present Law***

A taxpayer may elect to treat 50 percent of the cost of any qualified advanced mine safety equipment property as an expense in the taxable year in which the equipment is placed in service.<sup>453</sup> “Qualified advanced mine safety equipment property” means any advanced mine safety equipment property for use in any underground mine located in the United States the original use of which commences with the taxpayer and which is placed in service after December 20, 2006, and before January 1, 2014.<sup>454</sup>

Advanced mine safety equipment property means any of the following: (1) emergency communication technology or devices used to allow a miner to maintain constant communication with an individual who is not in the mine; (2) electronic identification and location devices that allow individuals not in the mine to track at all times the movements and location of miners working in or at the mine; (3) emergency oxygen-generating, self-rescue devices that provide oxygen for at least 90 minutes; (4) pre-positioned supplies of oxygen providing each miner on a shift the ability to survive for at least 48 hours; and (5) comprehensive atmospheric monitoring systems that monitor the levels of carbon monoxide, methane, and oxygen that are present in all areas of the mine and that can detect smoke in the case of a fire in a mine.<sup>455</sup>

### ***Explanation of Provision***

The provision extends for one year (through December 31, 2014) the present-law placed-in-service date allowing a taxpayer to expense 50 percent of the cost of any qualified advanced mine safety equipment property.

### ***Effective Date***

The provision applies to property placed in service after December 31, 2013.

<sup>453</sup> Sec. 179E(a).

<sup>454</sup> Secs. 179E(c) and (g).

<sup>455</sup> Sec. 179E(d).

**19. Extension of special expensing rules for certain film and television productions (sec. 129 of the Act and sec. 181 of the Code)**

***Present Law***

Under section 181, a taxpayer may elect<sup>456</sup> to deduct the cost of any qualifying film and television production, commencing prior to January 1, 2014, in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allowances.<sup>457</sup> A taxpayer may elect to deduct up to \$15 million of the aggregate cost of the film or television production under this section.<sup>458</sup> The threshold is increased to \$20 million if a significant amount of the production expenditures are incurred in areas eligible for designation as a low-income community or eligible for designation by the Delta Regional Authority as a distressed county or isolated area of distress.<sup>459</sup>

A qualified film or television production means any production of a motion picture (whether released theatrically or directly to video cassette or any other format) or television program if at least 75 percent of the total compensation expended on the production is for services performed in the United States by actors, directors, producers, and other relevant production personnel.<sup>460</sup> The term “compensation” does not include participations and residuals (as defined in section 167(g)(7)(B)).<sup>461</sup> Each episode of a television series is treated as a separate production, and only the first 44 episodes of a particular series qualify under the provision.<sup>462</sup> Qualified productions do not include sexually explicit productions as referenced by section 2257 of title 18 of the U.S. Code.<sup>463</sup>

For purposes of recapture under section 1245, any deduction allowed under section 181 is treated as if it were a deduction allowable for amortization.<sup>464</sup>

***Explanation of Provision***

The provision extends the special treatment for film and television productions under section 181 for one year to qualified film and television productions commencing prior to January 1, 2015.

***Effective Date***

The provision applies to productions commencing after December 31, 2013.

<sup>456</sup> See Treas. Reg. section 1.181-2 for rules on making an election under this section.

<sup>457</sup> For this purpose, a production is treated as commencing on the first date of principal photography.

<sup>458</sup> Sec. 181(a)(2)(A).

<sup>459</sup> Sec. 181(a)(2)(B).

<sup>460</sup> Sec. 181(d)(3)(A).

<sup>461</sup> Sec. 181(d)(3)(B).

<sup>462</sup> Sec. 181(d)(2)(B).

<sup>463</sup> Sec. 181(d)(2)(C).

<sup>464</sup> Sec. 1245(a)(2)(C).

**20. Extension of deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (sec. 130 of the Act and sec. 199 of the Code)**

***Present Law***

***General***

Present law generally provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to nine percent of the lesser of the taxpayer's qualified production activities income or taxable income for the taxable year. For taxpayers subject to the 35-percent corporate income tax rate, the nine-percent deduction effectively reduces the corporate income tax rate to slightly less than 32 percent on qualified production activities income.

In general, qualified production activities income is equal to domestic production gross receipts reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts; and (2) other expenses, losses, or deductions which are properly allocable to those receipts.

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property<sup>465</sup> that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States; (2) any sale, exchange, or other disposition, or any lease, rental, or license, of qualified film<sup>466</sup> produced by the taxpayer; (3) any lease, rental, license, sale, exchange, or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business; or (5) engineering or architectural services performed in the United States for the construction of real property located in the United States.

The amount of the deduction for a taxable year is limited to 50 percent of the wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.<sup>467</sup> Wages paid to bona fide residents of Puerto Rico generally are not included in the definition of wages for purposes of computing the wage limitation amount.<sup>468</sup>

***Rules for Puerto Rico***

When used in the Code in a geographical sense, the term "United States" generally includes only the States and the District of Co-

<sup>465</sup> Qualifying production property generally includes any tangible personal property, computer software, and sound recordings.

<sup>466</sup> Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.

<sup>467</sup> For purposes of the provision, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year.

<sup>468</sup> Section 3401(a)(8)(C) excludes wages paid to United States citizens who are bona fide residents of Puerto Rico from the term wages for purposes of income tax withholding.

lumbia.<sup>469</sup> A special rule for determining domestic production gross receipts, however, provides that in the case of any taxpayer with gross receipts from sources within the Commonwealth of Puerto Rico, the term “United States” includes the Commonwealth of Puerto Rico, but only if all of the taxpayer’s Puerto Rico-sourced gross receipts are taxable under the Federal income tax for individuals or corporations.<sup>470</sup> In computing the 50-percent wage limitation, the taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico.<sup>471</sup>

The special rules for Puerto Rico apply only with respect to the first eight taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2014.

### ***Explanation of Provision***

The provision extends the special domestic production activities rules for Puerto Rico to apply for the first nine taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2015.

### ***Effective Date***

The provision is effective for taxable years beginning after December 31, 2013.

## **21. Extension of modification of tax treatment of certain payments to controlling exempt organizations (sec. 131 of the Act and sec. 512 of the Code)**

### ***Present Law***

In general, organizations exempt from Federal income tax are subject to the unrelated business income tax on income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization’s tax-exempt functions.<sup>472</sup> In general, interest, rents, royalties, and annuities are excluded from the unrelated business income of tax-exempt organizations.<sup>473</sup>

Section 512(b)(13) provides rules regarding income derived by an exempt organization from a controlled subsidiary. In general, section 512(b)(13) treats otherwise excluded rent, royalty, annuity, and interest income as unrelated business taxable income if such income is received from a taxable or tax-exempt subsidiary that is 50-percent controlled by the parent tax-exempt organization to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity (determined as if the entity were tax exempt).

In the case of a stock subsidiary, “control” means ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, “control” means ownership of more than 50 percent of the profits, capital, or beneficial interests. In ad-

<sup>469</sup> Sec. 7701(a)(9).

<sup>470</sup> Sec. 199(d)(8)(A).

<sup>471</sup> Sec. 199(d)(8)(B).

<sup>472</sup> Sec. 511.

<sup>473</sup> Sec. 512(b).

dition, present law applies the constructive ownership rules of section 318 for purposes of section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

For payments made pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), the general rule of section 512(b)(13) applies only to the portion of payments received or accrued in a taxable year that exceeds the amount of the payment that would have been paid or accrued if the amount of such payment had been determined under the principles of section 482 (i.e., at arm's length).<sup>474</sup> A 20-percent penalty is imposed on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements. This special rule does not apply to payments received or accrued after December 31, 2013.

### ***Explanation of Provision***

The provision extends the special rule for one year to payments received or accrued before January 1, 2015. Accordingly, under the provision, payments of rent, royalties, annuities, or interest by a controlled organization to a controlling organization pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), may be includible in the unrelated business taxable income of the controlling organization only to the extent the payment exceeds the amount of the payment determined under the principles of section 482 (i.e., at arm's length). Any such excess is subject to a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

### ***Effective Date***

The provision is effective for payments received or accrued after December 31, 2013.

## **22. Extension of treatment of certain dividends of regulated investment companies (sec. 132 of the Act and sec. 871(k) of the Code)**

### ***Present Law***

#### ***In general***

A regulated investment company ("RIC") is an entity that meets certain requirements (including a requirement that its income generally be derived from passive investments such as dividends and interest and a requirement that it distribute at least 90 percent of its income) and that elects to be taxed under a special tax regime. Unlike an ordinary corporation, an entity that is taxed as a RIC can deduct amounts paid to its shareholders as dividends. In this

<sup>474</sup>Sec. 512(b)(13)(E).

manner, tax on RIC income is generally not paid by the RIC but rather by its shareholders. Income of a RIC distributed to shareholders as dividends is generally treated as an ordinary income dividend by those shareholders, unless other special rules apply. Dividends received by foreign persons from a RIC are generally subject to gross-basis tax under sections 871(a) or 881, and the RIC payor of such dividends is obligated to withhold such tax under sections 1441 and 1442.

Under a temporary provision of prior law, a RIC that earned certain interest income that generally would not be subject to U.S. tax if earned by a foreign person directly could, to the extent of such net interest income, designate a dividend it paid as derived from such interest income for purposes of the treatment of a foreign RIC shareholder. A foreign person who is a shareholder in the RIC generally could treat such a designated dividend as exempt from gross-basis U.S. tax. Also, subject to certain requirements, the RIC was exempt from withholding the gross-basis tax on such dividends. Similar rules applied with respect to the designation of certain short-term capital gain dividends. However, these provisions relating to dividends with respect to interest income and short-term capital gain of the RIC have expired, and therefore do not apply to dividends with respect to any taxable year of a RIC beginning after December 31, 2013.<sup>475</sup>

#### ***Explanation of Provision***

The provision extends the rules exempting from gross-basis tax and from withholding of such tax the interest-related dividends and short-term capital gain dividends received from a RIC, to dividends with respect to taxable years of a RIC beginning before January 1, 2015.

#### ***Effective Date***

The provision applies to dividends paid with respect to any taxable year of a RIC beginning after December 31, 2013.

### **23. Extension of RIC qualified investment entity treatment under FIRPTA (sec. 133 of the Act and secs. 897 and 1445 of the Code)**

#### ***Present Law***

Special U.S. tax rules apply to capital gains of foreign persons that are attributable to dispositions of interests in U.S. real property. In general, although a foreign person (a foreign corporation or a nonresident alien individual) is not generally taxed on U.S. source capital gains unless certain personal presence or active business requirements are met, a foreign person who sells a U.S. real property interest ("USRPI") is subject to tax at the same rates as a U.S. person, under the Foreign Investment in Real Property Tax Act ("FIRPTA") provisions codified in section 897 of the Code. Withholding tax is also imposed under section 1445.

<sup>475</sup> Secs. 871(k), 881(e), 1441(c)(12), 1441(a), and 1442.

A USRPI includes stock or a beneficial interest in any domestic corporation unless such corporation has not been a U.S. real property holding corporation (as defined) during the testing period. A USRPI does not include an interest in a domestically controlled “qualified investment entity.” A distribution from a “qualified investment entity” that is attributable to the sale of a USRPI is also subject to tax under FIRPTA unless the distribution is with respect to an interest that is regularly traded on an established securities market located in the United States and the recipient foreign corporation or nonresident alien individual did not hold more than five percent of that class of stock or beneficial interest within the one-year period ending on the date of distribution.<sup>476</sup> Special rules apply to situations involving tiers of qualified investment entities.

The term “qualified investment entity” includes a real estate investment trust (“REIT”) and also includes a regulated investment company (“RIC”) that meets certain requirements, although the inclusion of a RIC in that definition does not apply for certain purposes after December 31, 2013.<sup>477</sup>

#### ***Explanation of Provision***

The provision extends the inclusion of a RIC within the definition of a “qualified investment entity” under section 897 through December 31, 2014, for those situations in which that inclusion would otherwise have expired after December 31, 2013.

#### ***Effective Date***

The provision is generally effective on January 1, 2014.

The provision does not apply with respect to the withholding requirement under section 1445 for any payment made before the date of enactment (December 19, 2014), but a RIC that withheld and remitted tax under section 1445 on distributions made after December 31, 2013 and before the date of enactment is not liable to the distributee with respect to such withheld and remitted amounts.

### **24. Extension of subpart F exception for active financing income (sec. 134 of the Act and secs. 953 and 954 of the Code)**

#### ***Present Law***

Under the subpart F rules,<sup>478</sup> 10-percent-or-greater U.S. shareholders of a controlled foreign corporation (“CFC”) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, insurance income and foreign base company income. Foreign base company income includes, among other things, foreign personal holding company income and foreign base company services income (*i.e.*, income derived from services per-

<sup>476</sup> Sections 857(b)(3)(F), 852(b)(3)(E), and 871(k)(2)(E) require dividend treatment, rather than capital gain treatment, for certain distributions to which FIRPTA does not apply by reason of this exception. See also section 881(e)(2).

<sup>477</sup> Section 897(h).

<sup>478</sup> Secs. 951–964.

formed for or on behalf of a related person outside the country in which the CFC is organized).

Foreign personal holding company income generally consists of the following: (1) dividends, interest, royalties, rents, and annuities; (2) net gains from the sale or exchange of (a) property that gives rise to the preceding types of income, (b) property that does not give rise to income, and (c) interests in trusts, partnerships, and real estate mortgage investment conduits (“REMICs”); (3) net gains from commodities transactions; (4) net gains from certain foreign currency transactions; (5) income that is equivalent to interest; (6) income from notional principal contracts; (7) payments in lieu of dividends; and (8) amounts received under personal service contracts.

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC’s country of organization. Subpart F insurance income also includes income attributable to an insurance contract in connection with risks located within the CFC’s country of organization, as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other country risks. Investment income of a CFC that is allocable to any insurance or annuity contract related to risks located outside the CFC’s country of organization is taxable as subpart F insurance income.<sup>479</sup>

Temporary exceptions from foreign personal holding company income, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, as a securities dealer, or in the conduct of an insurance business (so-called “active financing income”).

With respect to income derived in the active conduct of a banking, financing, or similar business, a CFC is required to be predominantly engaged in such business and to conduct substantial activity with respect to such business to qualify for the active financing exceptions. In addition, certain nexus requirements apply, which provide that income derived by a CFC or a qualified business unit (“QBU”) of a CFC from transactions with customers is eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country’s tax laws. Moreover, the exceptions apply to income derived from certain cross border transactions, provided that certain requirements are met. Additional exceptions from foreign personal holding company income apply for certain income derived by a securities dealer within the meaning of section 475 and for gain from the sale of active financing assets.

In the case of a securities dealer, the temporary exception from foreign personal holding company income applies to certain income. The income covered by the exception is any interest or dividend (or

<sup>479</sup> Prop. Treas. Reg. sec. 1.953-1(a).



certain equivalent amounts) from any transaction, including a hedging transaction or a transaction consisting of a deposit of collateral or margin, entered into in the ordinary course of the dealer's trade or business as a dealer in securities within the meaning of section 475. In the case of a QBU of the dealer, the income is required to be attributable to activities of the QBU in the country of incorporation, or to a QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity. A coordination rule provides that this exception generally takes precedence over the exception for income of a banking, financing or similar business, in the case of a securities dealer.

In the case of insurance, a temporary exception from foreign personal holding company income applies for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization. In the case of insurance, temporary exceptions from insurance income and from foreign personal holding company income also apply for certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch, provided certain requirements are met under each of the exceptions. Further, additional temporary exceptions from insurance income and from foreign personal holding company income apply for certain income of certain CFCs or branches with respect to risks located in a country other than the United States, provided that the requirements for these exceptions are met. In the case of a life insurance or annuity contract, reserves for such contracts are determined under rules specific to the temporary exceptions. Present law also permits a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve of a life insurance company for life insurance and annuity contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

The temporary exceptions apply for taxable years of foreign corporations beginning after December 31, 1998 and before January 1, 2014, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

### ***Explanation of Provision***

The provision extends for one year (for taxable years beginning before January 1, 2015) the temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, as a securities dealer, or in the conduct of an insurance business.

### ***Effective Date***

The provision is effective for taxable years of foreign corporations beginning after December 31, 2013, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

### **25. Extension of look-thru treatment of payments between related controlled foreign corporations under foreign personal holding company rules (sec. 135 of the Act and sec. 954(c)(6) of the Code)**

#### ***Present Law***

##### ***In general***

The rules of subpart F<sup>480</sup> require U.S. shareholders with a 10-percent or greater interest in a controlled foreign corporation (“CFC”) to include certain income of the CFC (referred to as “subpart F income”) on a current basis for U.S. tax purposes, regardless of whether the income is distributed to the shareholders.

Subpart F income includes foreign base company income. One category of foreign base company income is foreign personal holding company income. For subpart F purposes, foreign personal holding company income generally includes dividends, interest, rents, and royalties, among other types of income. There are several exceptions to these rules. For example, foreign personal holding company income does not include dividends and interest received by a CFC from a related corporation organized and operating in the same foreign country in which the CFC is organized, or rents and royalties received by a CFC from a related corporation for the use of property within the country in which the CFC is organized. Interest, rent, and royalty payments do not qualify for this exclusion to the extent that such payments reduce the subpart F income of the payor. In addition, subpart F income of a CFC does not include any item of income from sources within the United States that is effectively connected with the conduct by such CFC of a trade or business within the United States (“ECI”) unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a tax treaty.

##### ***The “look-thru rule”***

Under the “look-thru rule” (sec. 954(c)(6)), dividends, interest (including factoring income that is treated as equivalent to interest under section 954(c)(1)(E)), rents, and royalties received or accrued by one CFC from a related CFC are not treated as foreign personal holding company income to the extent attributable or properly allocable to income of the payor that is neither subpart F income nor treated as ECI. For this purpose, a related CFC is a CFC that controls or is controlled by the other CFC, or a CFC that is controlled by the same person or persons that control the other CFC. Ownership of more than 50 percent of the CFC’s stock (by vote or value) constitutes control for these purposes.

<sup>480</sup> Secs. 951–964.

The Secretary is authorized to prescribe regulations that are necessary or appropriate to carry out the look-thru rule, including such regulations as are necessary or appropriate to prevent the abuse of the purposes of such rule.

The look-thru rule applies to taxable years of foreign corporations beginning after December 31, 2005 and before January 1, 2014, and to taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

### ***Explanation of Provision***

The provision extends for one year the application of the look-thru rule, to taxable years of foreign corporations beginning before January 1, 2015, and to taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

### ***Effective Date***

The provision is effective for taxable years of foreign corporations beginning after December 31, 2013, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

## **26. Extension of exclusion of 100 percent of gain on certain small business stock (sec. 136 of the Act and sec. 1202 of the Code)**

### ***Present Law***

#### ***In general***

A taxpayer other than a corporation may exclude 50 percent (60 percent for certain empowerment zone businesses) of the gain from the sale of certain small business stock acquired at original issue and held for at least five years.<sup>481</sup> The amount of gain eligible for the exclusion by an individual with respect to the stock of any corporation is the greater of (1) ten times the taxpayer's basis in the stock or (2) \$10 million (reduced by the amount of gain eligible for exclusion in prior years). To qualify as a small business, when the stock is issued, the aggregate gross assets (i.e., cash plus aggregate adjusted basis of other property) held by the corporation may not exceed \$50 million. The corporation also must meet certain active trade or business requirements.

The portion of the gain includible in taxable income is taxed at a maximum rate of 28 percent under the regular tax.<sup>482</sup> Seven percent of the excluded gain is an alternative minimum tax preference.<sup>483</sup>

#### ***Special rules for stock acquired after February 17, 2009, and before January 1, 2014***

For stock acquired after February 17, 2009, and before September 28, 2010, the percentage exclusion for qualified small business stock sold by an individual is increased to 75 percent.

<sup>481</sup> Sec. 1202.

<sup>482</sup> Sec. 1(h).

<sup>483</sup> Sec. 57(a)(7).

For stock acquired after September 27, 2010, and before January 1, 2014, the percentage exclusion for qualified small business stock sold by an individual is increased to 100 percent and the minimum tax preference does not apply.

***Explanation of Provision***

The provision extends the 100-percent exclusion and the exception from minimum tax preference treatment for one year (for stock acquired before January 1, 2015).

***Effective Date***

The provision is effective for stock acquired after December 31, 2013.

**27. Extension of basis adjustment to stock of S corporations making charitable contributions of property (sec. 137 of the Act and sec. 1367 of the Code)**

***Present Law***

Under present law, if an S corporation contributes money or other property to a charity, each shareholder takes into account the shareholder's pro rata share of the contribution in determining its own income tax liability.<sup>484</sup> A shareholder of an S corporation reduces the basis in the stock of the S corporation by the amount of the charitable contribution that flows through to the shareholder.<sup>485</sup>

In the case of charitable contributions made in taxable years beginning before January 1, 2014, the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation is equal to the shareholder's pro rata share of the adjusted basis of the contributed property. For contributions made in taxable years beginning after December 31, 2013, the amount of the reduction is the shareholder's pro rata share of the fair market value of the contributed property.

***Explanation of Provision***

The provision extends the rule relating to the basis reduction on account of charitable contributions of property for one year to contributions made in taxable years beginning before January 1, 2015.

***Effective Date***

The provision applies to charitable contributions made in taxable years beginning after December 31, 2013.

<sup>484</sup> Sec. 1366(a)(1)(A).

<sup>485</sup> Sec. 1367(a)(2)(B).

## 28. Extension of reduction in S corporation recognition period for built-in gains tax (sec. 138 of the Act and sec. 1374 of the Code)

### *Present Law*

#### *In general*

A “small business corporation” (as defined in section 1361(b)) may elect to be treated as an S corporation. Unlike C corporations, S corporations generally pay no corporate-level tax. Instead, items of income and loss of an S corporation pass through to its shareholders. Each shareholder takes into account separately its share of these items on its own income tax return.<sup>486</sup>

Under section 1374, a corporate level built-in gains tax, at the highest marginal rate applicable to corporations (currently 35 percent), is imposed on an S corporation’s net recognized built-in gain<sup>487</sup> that arose prior to the conversion of the C corporation to an S corporation and is recognized by the S corporation during the recognition period, *i.e.*, the 10-year period beginning with the first day of the first taxable year for which the S election is in effect.<sup>488</sup> If the taxable income of the S corporation is less than the amount of net recognized built-in gain in the year such built-in gain is recognized (for example, because of post-conversion losses), no tax under section 1374 is imposed on the excess of such built-in gain over taxable income for that year. However, the untaxed excess of net recognized built-in gain over taxable income for that year is treated as recognized built-in gain in the succeeding taxable year.<sup>489</sup> Treasury regulations provide that if a corporation sells an asset before or during the recognition period and reports the income from the sale using the installment method under section 453 during or after the recognition period, that income is subject to tax under section 1374.<sup>490</sup>

The built-in gains tax also applies to net recognized built-in gain attributable to any asset received by an S corporation from a C corporation in a transaction in which the S corporation’s basis in the asset is determined (in whole or in part) by reference to the basis of such asset (or other property) in the hands of the C corporation.<sup>491</sup> In the case of such a transaction, the recognition period for any asset transferred by the C corporation starts on the date the asset was acquired by the S corporation in lieu of the beginning of the first taxable year for which the corporation was an S corporation.<sup>492</sup>

<sup>486</sup> Sec. 1366.

<sup>487</sup> Certain built-in income items are treated as recognized built-in gain for this purpose. Sec. 1374(d)(5).

<sup>488</sup> Sec. 1374(d)(7)(A). The 10-year period refers to ten calendar years from the first day of the first taxable year for which the corporation was an S corporation. Treas. Reg. sec. 1.1374-1(d). A regulated investment company (RIC) or a real estate investment trust (REIT) that was formerly a C corporation (or that acquired assets from a C corporation) generally is subject to the rules of section 1374 as if the RIC or REIT were an S corporation, unless the relevant C corporation elects “deemed sale” treatment. Treas. Reg. secs. 1.337(d)-7(b)(1) and (c)(1).

<sup>489</sup> Sec. 1374(d)(2).

<sup>490</sup> Treas. Reg. sec. 1.1374-4(h).

<sup>491</sup> Sec. 1374(d)(8).

<sup>492</sup> Sec. 1374(d)(8)(B).

The amount of the built-in gains tax under section 1374 is treated as a loss by each of the S corporation shareholders in computing its own income tax.<sup>493</sup>

***Special rules for 2009, 2010, and 2011***

For any taxable year beginning in 2009 and 2010, no tax was imposed on the net recognized built-in gain of an S corporation under section 1374 if the seventh taxable year in the corporation's recognition period preceded such taxable year.<sup>494</sup> Thus, with respect to gain that arose prior to the conversion of a C corporation to an S corporation, no tax was imposed under section 1374 if the seventh taxable year that the S corporation election was in effect preceded the taxable year beginning in 2009 or 2010.

For any taxable year beginning in 2011, no tax was imposed on the net recognized built-in gain of an S corporation under section 1374 if the fifth year in the corporation's recognition period preceded such taxable year.<sup>495</sup> Thus, with respect to gain that arose prior to the conversion of a C corporation to an S corporation, no tax was imposed under section 1374 if the S corporation election was in effect for five years preceding the taxable year beginning in 2011.

***Special rules for 2012 and 2013***

For taxable years beginning in 2012 and 2013, the term "recognition period" in section 1374, for purposes of determining the net recognized built-in gain, is applied by substituting a five-year period for the otherwise applicable 10-year period. Thus, for such taxable years, the recognition period is the five-year period beginning with the first day of the first taxable year for which the corporation was an S corporation (or beginning with the date of acquisition of assets if the rules applicable to assets acquired from a C corporation apply). If an S corporation with assets subject to section 1374 disposes of such assets in a taxable year beginning in 2012 or 2013 and the disposition occurs more than five years after the first day of the relevant recognition period, gain or loss on the disposition will not be taken into account in determining the net recognized built-in gain.

The rule requiring the excess of net recognized built-in gain over taxable income for a taxable year to be carried over and treated as recognized built-in gain in the succeeding taxable year applies only to gain recognized within the recognition period. Thus, for example, built-in gain recognized in a taxable year beginning in 2013, from a disposition in that year that occurs beyond the end of the temporary 5-year recognition period, will not be carried forward under the income limitation rule and treated as recognized built-in gain in the taxable year beginning in 2014 (after the temporary provision has expired and the recognition period is again 10 years).<sup>496</sup>

If an S corporation subject to section 1374 sells a built-in gain asset and reports the income from the sale using the installment

<sup>493</sup> Sec. 1366(f)(2). Shareholders continue to take into account all items of gain and loss under section 1366.

<sup>494</sup> Sec. 1374(d)(7)(B).

<sup>495</sup> Sec. 1374(d)(7)(C).

<sup>496</sup> Sec. 1374(d)(2)(B).

method under section 453, the treatment of all payments received will be governed by the provisions of section 1374(d)(7) applicable to the taxable year in which the sale was made. Thus, for example, if an S corporation sold a built-in gain asset in 2008 in a sale occurring before or during the recognition period in effect at that time, and reported the gain using the installment method under section 453, gain recognized under that method in 2012 or 2013 (including, for example, any gain under section 453B from a disposition of the installment obligation in those years)<sup>497</sup> is subject to tax under section 1374. On the other hand, if a corporation sold an asset in a taxable year beginning in 2012 or 2013, and the sale occurred beyond the end of the then-effective 5-year recognition period (but not beyond the end of the otherwise applicable 10-year recognition period), then gain reported using the installment method under section 453 in a taxable year beginning in 2014 (after the temporary provision expires) is not subject to tax under section 1374, because the sale was made after the end of the recognition period applicable to that sale. As a third example, if an S corporation sold an asset in a taxable year beginning in 2011, and no tax would have been imposed on the net recognized built-in gain from the sale under section 1374(d)(7)(B)(ii) because the fifth taxable year in the recognition period preceded such taxable year, then gain from such sale reported using the installment method under section 453 in a taxable year beginning in 2014 is not subject to tax under section 1374.<sup>498</sup>

### ***Explanation of Provision***

The provision extends for one year, to taxable years beginning in 2014, the special rules that applied to taxable years beginning in 2012 and 2013.

### ***Effective Date***

The provision is effective for taxable years beginning after December 31, 2013.

## **29. Extension of empowerment zone tax incentives (sec. 139 of the Act and sec. 1391 of the Code)**

### ***Present Law***

The Omnibus Budget Reconciliation Act of 1993 (“OBRA 93”)<sup>499</sup> authorized the designation of nine empowerment zones (“Round I empowerment zones”) to provide tax incentives for businesses to locate within certain targeted areas<sup>500</sup> designated by the Secretaries of the Department of Housing and Urban Development (“HUD”) and the U.S. Department of Agriculture (“USDA”). The first empowerment zones were established in large rural areas and large

<sup>497</sup> Section 453B requires gain or loss to be recognized on disposition of an installment obligation and treated as gain or loss resulting from the sale or exchange of the property in respect of which the installment obligation was received.

<sup>498</sup> Report of the Senate Committee on Finance to Accompany S. 3521, the Family and Business Tax Cut Certainty Act of 2012, S. Rep. 112–208, August 28, 2012, pp 69–72.

<sup>499</sup> Pub. L. No. 103–66.

<sup>500</sup> The targeted areas are those that have pervasive poverty, high unemployment, and general economic distress, and that satisfy certain eligibility criteria, including specified poverty rates and population and geographic size limitations.

cities. OBRA 93 also authorized the designation of 95 enterprise communities, which were located in smaller rural areas and cities. For tax purposes, the areas designated as enterprise communities continued as such for the ten-year period starting in the beginning of 1995 and ending at the end of 2004.

The Taxpayer Relief Act of 1997<sup>501</sup> authorized the designation of two additional Round I urban empowerment zones, and 20 additional empowerment zones (“Round II empowerment zones”). The Community Renewal Tax Relief Act of 2000 (“2000 Community Renewal Act”)<sup>502</sup> authorized a total of ten new empowerment zones (“Round III empowerment zones”), bringing the total number of authorized empowerment zones to 40.<sup>503</sup> In addition, the 2000 Community Renewal Act conformed the tax incentives that are available to businesses in the Round I, Round II, and Round III empowerment zones, and extended the empowerment zone incentives through December 31, 2009.<sup>504</sup> The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (“TRUIRCA”) extended for two years, through December 31, 2011, the period for which the designation of an empowerment zone was in effect, thus extending for two years the empowerment zone tax incentives discussed below.<sup>505</sup> The American Taxpayer Relief Act of 2012 (“ATRA”) extended the designation period and tax incentives for two additional years, through December 31, 2013.<sup>506</sup>

The tax incentives available within the designated empowerment zones include a Federal income tax credit for employers who hire qualifying employees (the “wage credit”), accelerated depreciation deductions on qualifying equipment, tax-exempt bond financing, deferral of capital gains tax on sale of qualified assets sold and replaced, and partial exclusion of capital gains tax on certain sales of qualified small business stock.

The following is a description of the tax incentives:

### ***Wage credit***

A 20-percent wage credit is available to employers for the first \$15,000 of qualified wages paid to each employee (*i.e.*, a maximum

<sup>501</sup> Pub. L. No. 105–34.

<sup>502</sup> Pub. L. No. 106–554.

<sup>503</sup> The urban part of the program is administered by HUD and the rural part of the program is administered by the USDA. The eight Round I urban empowerment zones are Atlanta, GA; Baltimore, MD; Chicago, IL; Cleveland, OH; Detroit, MI; Los Angeles, CA; New York, NY; and Philadelphia, PA/Camden, NJ. Atlanta relinquished its empowerment zone designation in Round III. The three Round I rural empowerment zones are Kentucky Highlands, KY; Mid-Delta, MI; and Rio Grande Valley, TX. The 15 Round II urban empowerment zones are Boston, MA; Cincinnati, OH; Columbia, SC; Columbus, OH; Cumberland County, NJ; El Paso, TX; Gary/Hammond/East Chicago, IN; Ironton, OH/Huntington, WV; Knoxville, TN; Miami/Dade County, FL; Minneapolis, MN; New Haven, CT; Norfolk/Portsmouth, VA; Santa Ana, CA; and St. Louis, Missouri/East St. Louis, IL. The five Round II rural empowerment zones are Desert Communities, CA; Griggs-Steele, ND; Oglala Sioux Tribe, SD; Southernmost Illinois Delta, IL; and Southwest Georgia United, GA. The eight Round III urban empowerment zones are Fresno, CA; Jacksonville, FL; Oklahoma City, OK; Pulaski County, AR; San Antonio, TX; Syracuse, NY; Tucson, AZ; and Yonkers, NY. The two Round III rural empowerment zones are Aroostook County, ME; and Futuro, TX.

<sup>504</sup> If an empowerment zone designation were terminated prior to December 31, 2009, the tax incentives would cease to be available as of the termination date.

<sup>505</sup> Pub. L. No. 111–312, sec. 753 (2010). In the case of a designation of an empowerment zone the nomination for which included a termination date which is December 31, 2009, termination shall not apply with respect to such designation if the entity which made such nomination amends the nomination to provide for a new termination date in such manner as the Secretary may provide.

<sup>506</sup> Pub. L. No. 112–240, sec. 327 (2013).



credit of \$3,000 with respect to each qualified employee) who (1) is a resident of the empowerment zone, and (2) performs substantially all employment services within the empowerment zone in a trade or business of the employer.<sup>507</sup>

The wage credit rate applies to qualifying wages paid before January 1, 2012. Wages paid to a qualified employee who earns more than \$15,000 are eligible for the wage credit (although only the first \$15,000 of wages is eligible for the credit). The wage credit is available with respect to a qualified full-time or part-time employee (employed for at least 90 days), regardless of the number of other employees who work for the employer. In general, any taxable business carrying out activities in the empowerment zone may claim the wage credit, regardless of whether the employer meets the definition of an “enterprise zone business.”<sup>508</sup>

An employer’s deduction otherwise allowed for wages paid is reduced by the amount of wage credit claimed for that taxable year.<sup>509</sup> Wages are not to be taken into account for purposes of the wage credit if taken into account in determining the employer’s work opportunity tax credit under section 51 or the welfare-to-work credit under section 51A.<sup>510</sup> In addition, the \$15,000 cap is reduced by any wages taken into account in computing the work opportunity tax credit or the welfare-to-work credit.<sup>511</sup> The wage credit may be used to offset up to 25 percent of alternative minimum tax liability.<sup>512</sup>

### ***Increased section 179 expensing limitation***

An enterprise zone business is allowed an additional \$35,000 of section 179 expensing (for a total of up to \$535,000 in 2010 and 2011)<sup>513</sup> for qualified zone property placed in service before January 1, 2012.<sup>514</sup> The section 179 expensing allowed to a taxpayer is phased out by the amount by which 50 percent of the cost of qualified zone property placed in service during the year by the taxpayer exceeds \$2,000,000.<sup>515</sup> The term “qualified zone property” is defined as depreciable tangible property (including buildings) provided that (i) the property is acquired by the taxpayer (from an unrelated party) after the designation took effect, (ii) the original use of the property in an empowerment zone commences with the taxpayer, and (iii) substantially all of the use of the property is in an empowerment zone in the active conduct of a trade or business by

<sup>507</sup> Sec. 1396. The \$15,000 limit is annual, not cumulative such that the limit is the first \$15,000 of wages paid in a calendar year which ends with or within the taxable year.

<sup>508</sup> Secs. 1397C(b) and 1397C(c). However, the wage credit is not available for wages paid in connection with certain business activities described in section 144(c)(6)(B), including a golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack, or liquor store, or certain farming activities. In addition, wages are not eligible for the wage credit if paid to: (1) a person who owns more than five percent of the stock (or capital or profits interests) of the employer, (2) certain relatives of the employer, or (3) if the employer is a corporation or partnership, certain relatives of a person who owns more than 50 percent of the business.

<sup>509</sup> Sec. 280C(a).

<sup>510</sup> Secs. 1396(c)(3)(A) and 51A(d)(2).

<sup>511</sup> Secs. 1396(c)(3)(B) and 51A(d)(2).

<sup>512</sup> Sec. 38(c)(2).

<sup>513</sup> The Small Business Jobs Act of 2010, Pub. L. No. 111–240, sec. 2021.

<sup>514</sup> Secs. 1397A, 1397D.

<sup>515</sup> Sec. 1397A(a)(2), 179(b)(2). For 2012 the limit is \$500,000. For taxable years beginning after 2012, the limit is \$200,000.

the taxpayer. Special rules are provided in the case of property that is substantially renovated by the taxpayer.

An enterprise zone business means any qualified business entity and any qualified proprietorship. A qualified business entity means, any corporation or partnership if for such year: (1) every trade or business of such entity is the active conduct of a qualified business within an empowerment zone; (2) at least 50 percent of the total gross income of such entity is derived from the active conduct of such business; (3) a substantial portion of the use of the tangible property of such entity (whether owned or leased) is within an empowerment zone; (4) a substantial portion of the intangible property of such entity is used in the active conduct of any such business; (5) a substantial portion of the services performed for such entity by its employees are performed in an empowerment zone; (6) at least 35 percent of its employees are residents of an empowerment zone; (7) less than five percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to collectibles other than collectibles that are held primarily for sale to customers in the ordinary course of such business; and (8) less than five percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property.<sup>516</sup>

A qualified proprietorship is any qualified business carried on by an individual as a proprietorship if for such year: (1) at least 50 percent of the total gross income of such individual from such business is derived from the active conduct of such business in an empowerment zone; (2) a substantial portion of the use of the tangible property of such individual in such business (whether owned or leased) is within an empowerment zone; (3) a substantial portion of the intangible property of such business is used in the active conduct of such business; (4) a substantial portion of the services performed for such individual in such business by employees of such business are performed in an empowerment zone; (5) at least 35 percent of such employees are residents of an empowerment zone; (6) less than five percent of the average of the aggregate unadjusted bases of the property of such individual which is used in such business is attributable to collectibles other than collectibles that are held primarily for sale to customers in the ordinary course of such business; and (7) less than five percent of the average of the aggregate unadjusted bases of the property of such individual which is used in such business is attributable to nonqualified financial property.<sup>517</sup>

A qualified business is defined as any trade or business other than a trade or business that consists predominantly of the development or holding of intangibles for sale or license or any business prohibited in connection with the employment credit.<sup>518</sup> In addition, the leasing of real property that is located within the empowerment zone is treated as a qualified business only if (1) the leased property is not residential property, and (2) at least 50 per-

<sup>516</sup>Sec. 1397C(b).

<sup>517</sup>Sec. 1397C(c).

<sup>518</sup>Sec. 1397C(d). Excluded businesses include any private or commercial golf course, country club, massage parlor, hot tub facility, sun tan facility, racetrack, or other facility used for gambling or any store the principal business of which is the sale of alcoholic beverages for off-premises consumption. Sec. 144(c)(6).

cent of the gross rental income from the real property is from enterprise zone businesses. The rental of tangible personal property is not a qualified business unless at least 50 percent of the rental of such property is by enterprise zone businesses or by residents of an empowerment zone.

***Expanded tax-exempt financing for certain zone facilities***

States or local governments can issue enterprise zone facility bonds to raise funds to provide an enterprise zone business with qualified zone property.<sup>519</sup> These bonds can be used in areas designated enterprise communities as well as areas designated empowerment zones. To qualify, 95 percent (or more) of the net proceeds from the bond issue must be used to finance: (1) qualified zone property whose principal user is an enterprise zone business, and (2) certain land functionally related and subordinate to such property.

The term enterprise zone business is the same as that used for purposes of the increased section 179 deduction limitation (discussed above) with certain modifications for start-up businesses. First, a business will be treated as an enterprise zone business during a start-up period if (1) at the beginning of the period, it is reasonable to expect the business to be an enterprise zone business by the end of the start-up period, and (2) the business makes bona fide efforts to be an enterprise zone business. The start-up period is the period that ends with the start of the first tax year beginning more than two years after the later of (1) the issue date of the bond issue financing the qualified zone property, and (2) the date this property is first placed in service (or, if earlier, the date that is three years after the issue date).<sup>520</sup>

Second, a business that qualifies as an enterprise zone business at the end of the start-up period must continue to qualify during a testing period that ends three tax years after the start-up period ends. After the three-year testing period, a business will continue to be treated as an enterprise zone business as long as 35 percent of its employees are residents of an empowerment zone or enterprise community.

The face amount of the bonds may not exceed \$60 million for an empowerment zone in a rural area, \$130 million for an empowerment zone in an urban area with zone population of less than 100,000, and \$230 million for an empowerment zone in an urban area with zone population of at least 100,000.

***Elective rollover of capital gain from the sale or exchange of any qualified empowerment zone asset***

Taxpayers can elect to defer recognition of gain on the sale of a qualified empowerment zone asset<sup>521</sup> held for more than one year

<sup>519</sup> Sec. 1394.

<sup>520</sup> Sec. 1394(b)(3).

<sup>521</sup> The term "qualified empowerment zone asset" means any property which would be a qualified community asset (as defined in section 1400F, relating to certain tax benefits for renewal communities) if in section 1400F: (i) references to empowerment zones were substituted for references to renewal communities, (ii) references to enterprise zone businesses (as defined in section 1397C) were substituted for references to renewal community businesses, and (iii) the date of the enactment of this paragraph were substituted for "December 31, 2001" each place it appears. Sec. 1397B(b)(1)(A).

and replaced within 60 days by another qualified empowerment zone asset in the same zone.<sup>522</sup> The deferral is accomplished by reducing the basis of the replacement asset by the amount of the gain recognized on the sale of the asset.

***Partial exclusion of capital gains on certain small business stock***

Generally, individuals may exclude a percentage of gain from the sale of certain small business stock acquired at original issue and held at least five years.<sup>523</sup> For stock acquired prior to February 18, 2009, or after December 31, 2013, the percentage is generally 50 percent, except that for empowerment zone stock the percentage is 60 percent for gain attributable to periods before January 1, 2019. For stock acquired after February 17, 2009, and before January 1, 2014, a higher percentage (either 75-percent or 100-percent) applies to all small business stock with no additional percentage for empowerment zone stock.<sup>524</sup>

***Other tax incentives***

Other incentives not specific to empowerment zones but beneficial to these areas include the work opportunity tax credit for employers based on the first year of employment of certain targeted groups, including empowerment zone residents (up to \$2,400 per employee), and qualified zone academy bonds for certain public schools located in an empowerment zone, or expected (as of the date of bond issuance) to have at least 35 percent of its students receiving free or reduced lunches.

***Explanation of Provision***

The provision extends for one year, through December 31, 2014, the period for which the designation of an empowerment zone is in effect, thus extending for one year the empowerment zone tax incentives, including the wage credit, increased section 179 expensing for qualifying equipment, tax-exempt bond financing, and deferral of capital gains tax on sale of qualified assets replaced with other qualified assets. In the case of a designation of an empowerment zone the nomination for which included a termination date which is December 31, 2013, termination shall not apply with respect to such designation if the entity which made such nomination amends the nomination to provide for a new termination date in such manner as the Secretary may provide.

***Effective Date***

The provision applies to periods after December 31, 2013.

---

A "qualified community asset" includes: (1) qualified community stock (meaning original-issue stock purchased for cash in an enterprise zone business), (2) a qualified community partnership interest (meaning a partnership interest acquired for cash in an enterprise zone business), and (3) qualified community business property (meaning tangible property originally used in an enterprise zone business by the taxpayer) that is purchased or substantially improved after the date of the enactment of this paragraph.

<sup>522</sup> Sec. 1397B.

<sup>523</sup> Sec. 1202.

<sup>524</sup> Section 136 of the Act extends the 100-percent exclusion to small business stock acquired during 2014.

**30. Extension of temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands (sec. 140 of the Act and sec. 7652(f) of the Code)**

***Present Law***

A \$13.50 per proof gallon<sup>525</sup> excise tax is imposed on distilled spirits produced in or imported into the United States.<sup>526</sup> The excise tax does not apply to distilled spirits that are exported from the United States, including exports to U.S. possessions (e.g., Puerto Rico and the Virgin Islands).<sup>527</sup>

The Code provides for cover over (payment) to Puerto Rico and the Virgin Islands of the excise tax imposed on rum imported (or brought) into the United States, without regard to the country of origin.<sup>528</sup> The amount of the cover over is limited under Code section 7652(f) to \$10.50 per proof gallon (\$13.25 per proof gallon after June 30, 1999, and before January 1, 2014).

Tax amounts attributable to shipments to the United States of rum produced in Puerto Rico are covered over to Puerto Rico. Tax amounts attributable to shipments to the United States of rum produced in the Virgin Islands are covered over to the Virgin Islands. Tax amounts attributable to shipments to the United States of rum produced in neither Puerto Rico nor the Virgin Islands are divided and covered over to the two possessions under a formula.<sup>529</sup> Amounts covered over to Puerto Rico and the Virgin Islands are deposited into the treasuries of the two possessions for use as those possessions determine.<sup>530</sup> All of the amounts covered over are subject to the limitation.

***Explanation of Provision***

The provision suspends for one year the \$10.50 per proof gallon limitation on the amount of excise taxes on rum covered over to Puerto Rico and the Virgin Islands. Under the provision, the cover over limitation of \$13.25 per proof gallon is extended for rum brought into the United States after December 31, 2013 and before January 1, 2015. After December 31, 2014, the cover over amount reverts to \$10.50 per proof gallon.

***Effective Date***

The provision is effective for articles brought into the United States after December 31, 2013.

<sup>525</sup> A proof gallon is a liquid gallon consisting of 50 percent alcohol. See sec. 5002(a)(10) and (11).

<sup>526</sup> Sec. 5001(a)(1).

<sup>527</sup> Secs. 5214(a)(1)(A), 5002(a)(15), 7653(b) and (c). See also Treas. Reg. Sec. 48.0-2(a)(11) for the definition of "possession of the United States" for purposes of the manufacturers and retailers excise tax regulations.

<sup>528</sup> Secs. 7652(a)(3), (b)(3), and (e)(1). One percent of the amount of excise tax collected from imports into the United States of articles produced in the Virgin Islands is retained by the United States under section 7652(b)(3).

<sup>529</sup> Sec. 7652(e)(2).

<sup>530</sup> Secs. 7652(a)(3), (b)(3), and (e)(1).

**31. Extension of American Samoa Economic Development Credit (sec. 141 of the Act and sec. 119 of Pub. L. No. 109-432)**

***Present Law***

A domestic corporation that was an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006 is allowed a credit based on the corporation's economic activity-based limitation with respect to American Samoa. The credit is not part of the Code but is computed based on the rules of sections 30A and 936. The credit is allowed for the first eight taxable years of a corporation that begin after December 31, 2005, and before January 1, 2014.

A corporation was an existing credit claimant with respect to American Samoa if (1) the corporation was engaged in the active conduct of a trade or business within American Samoa on October 13, 1995, and (2) the corporation elected the benefits of the possession tax credit<sup>531</sup> in an election in effect for its taxable year that included October 13, 1995.<sup>532</sup> A corporation that added a substantial new line of business (other than in a qualifying acquisition of all the assets of a trade or business of an existing credit claimant) ceased to be an existing credit claimant as of the close of the taxable year ending before the date on which that new line of business was added.

The amount of the credit allowed to a qualifying domestic corporation under the provision is equal to the sum of the amounts used in computing the corporation's economic activity-based limitation with respect to American Samoa, except that no credit is allowed for the amount of any American Samoa income taxes. Thus, for any qualifying corporation the amount of the credit equals the sum of (1) 60 percent of the corporation's qualified American Samoa wages and allocable employee fringe benefit expenses and (2) 15 percent of the corporation's depreciation allowances with re-

<sup>531</sup> For taxable years beginning before January 1, 2006, certain domestic corporations with business operations in the U.S. possessions were eligible for the possession tax credit. Secs. 27(b), 936. This credit offset the U.S. tax imposed on certain income related to operations in the U.S. possessions. Subject to certain limitations, the amount of the possession tax credit allowed to any domestic corporation equaled the portion of that corporation's U.S. tax that was attributable to the corporation's non-U.S. source taxable income from (1) the active conduct of a trade or business within a U.S. possession, (2) the sale or exchange of substantially all of the assets that were used in such a trade or business, or (3) certain possessions investment. No deduction or foreign tax credit was allowed for any possessions or foreign tax paid or accrued with respect to taxable income that was taken into account in computing the credit under section 936. Under the economic activity-based limit, the amount of the credit could not exceed an amount equal to the sum of (1) 60 percent of the taxpayer's qualified possession wages and allocable employee fringe benefit expenses, (2) 15 percent of depreciation allowances with respect to short-life qualified tangible property, plus 40 percent of depreciation allowances with respect to medium-life qualified tangible property, plus 65 percent of depreciation allowances with respect to long-life qualified tangible property, and (3) in certain cases, a portion of the taxpayer's possession income taxes. A taxpayer could elect, instead of the economic activity-based limit, a limit equal to the applicable percentage of the credit that otherwise would have been allowable with respect to possession business income, beginning in 1998, the applicable percentage was 40 percent.

To qualify for the possession tax credit for a taxable year, a domestic corporation was required to satisfy two conditions. First, the corporation was required to derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation was required to derive at least 75 percent of its gross income for that same period from the active conduct of a possession business. Sec. 936(a)(2). The section 936 credit generally expired for taxable years beginning after December 31, 2005.

spect to short-life qualified American Samoa tangible property, plus 40 percent of the corporation's depreciation allowances with respect to medium-life qualified American Samoa tangible property, plus 65 percent of the corporation's depreciation allowances with respect to long-life qualified American Samoa tangible property.

The section 936(c) rule denying a credit or deduction for any possessions or foreign tax paid with respect to taxable income taken into account in computing the credit under section 936 does not apply with respect to the credit allowed by the provision.

For taxable years beginning after December 31, 2011 the credit rules are modified in two ways. First, domestic corporations with operations in American Samoa are allowed the credit even if those corporations are not existing credit claimants. Second, the credit is available to a domestic corporation (either an existing credit claimant or a new credit claimant) only if, in addition to satisfying all the present law requirements for claiming the credit, the corporation also has qualified production activities income (as defined in section 199(c) by substituting "American Samoa" for "the United States" in each place that latter term appears).

In the case of a corporation that is an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006, the credit applies to the first eight taxable years of the corporation which begin after December 31, 2005, and before January 1, 2014. For any other corporation, the credit applies to the first two taxable years of that corporation which begin after December 31, 2011 and before January 1, 2014.

#### ***Explanation of Provision***

The provision extends the credit for one year to apply (a) in the case of a corporation that is an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006, to the first nine taxable years of the corporation which begin after December 31, 2005, and before January 1, 2015, and (b) in the case of any other corporation, to the first three taxable years of the corporation which begin after December 31, 2011 and before January 1, 2015.

#### ***Effective Date***

The provision applies to taxable years beginning after December 31, 2013.

### C. Subtitle C—Energy Tax Extenders

#### 1. Extension of credit for nonbusiness energy property (sec. 151 of the Act and sec. 25C of the Code)

##### *Present Law*

Present law provides a 10-percent credit for the purchase of qualified energy efficiency improvements to existing homes.<sup>533</sup> A qualified energy efficiency improvement is any energy efficiency building envelope component (1) that meets or exceeds the prescriptive criteria for such a component established by the 2009 International Energy Conservation Code as such Code (including supplements) is in effect on the date of the enactment of the American Recovery and Reinvestment Tax Act of 2009<sup>534</sup> (or, in the case of windows, skylights and doors, and metal roofs with appropriate pigmented coatings or asphalt roofs with appropriate cooling granules, meets the Energy Star program requirements); (2) that is installed in or on a dwelling located in the United States and owned and used by the taxpayer as the taxpayer's principal residence; (3) the original use of which commences with the taxpayer; and (4) that reasonably can be expected to remain in use for at least five years. The credit is nonrefundable.

Building envelope components are: (1) insulation materials or systems which are specifically and primarily designed to reduce the heat loss or gain for a dwelling and which meet the prescriptive criteria for such material or system established by the 2009 International Energy Conservation Code, as such Code (including supplements) is in effect on the date of the enactment of the American Recovery and Reinvestment Tax Act of 2009;<sup>535</sup> (2) exterior windows (including skylights) and doors; and (3) metal or asphalt roofs with appropriate pigmented coatings or cooling granules that are specifically and primarily designed to reduce the heat gain for a dwelling.

Additionally, present law provides specified credits for the purchase of specific energy efficient property originally placed in service by the taxpayer during the taxable year. The allowable credit for the purchase of certain property is (1) \$50 for each advanced main air circulating fan, (2) \$150 for each qualified natural gas, propane, or oil furnace or hot water boiler, and (3) \$300 for each item of energy efficient building property.

An advanced main air circulating fan is a fan used in a natural gas, propane, or oil furnace and which has an annual electricity use of no more than two percent of the total annual energy use of the furnace (as determined in the standard Department of Energy test procedures).

A qualified natural gas, propane, or oil furnace or hot water boiler is a natural gas, propane, or oil furnace or hot water boiler with an annual fuel utilization efficiency rate of at least 95.

<sup>532</sup> A corporation will qualify as an existing credit claimant if it acquired all the assets of a trade or business of a corporation that (1) actively conducted that trade or business in a possession on October 13, 1995, and (2) had elected the benefits of the possession tax credit in an election in effect for the taxable year that included October 13, 1995.

<sup>533</sup> Sec. 25C.

<sup>534</sup> Pub. L. No. 111-5, February 17, 2009.



Energy-efficient building property is: (1) an electric heat pump water heater which yields an energy factor of at least 2.0 in the standard Department of Energy test procedure, (2) an electric heat pump which achieves the highest efficiency tier established by the Consortium for Energy Efficiency, as in effect on January 1, 2009,<sup>536</sup> (3) a central air conditioner which achieves the highest efficiency tier established by the Consortium for Energy Efficiency as in effect on January 1, 2009,<sup>537</sup> (4) a natural gas, propane, or oil water heater which has an energy factor of at least 0.82 or thermal efficiency of at least 90 percent, and (5) biomass fuel property.

Biomass fuel property is a stove that burns biomass fuel to heat a dwelling unit located in the United States and used as a principal residence by the taxpayer, or to heat water for such dwelling unit, and that has a thermal efficiency rating of at least 75 percent. Biomass fuel is any plant-derived fuel available on a renewable or recurring basis, including agricultural crops and trees, wood and wood waste and residues (including wood pellets), plants (including aquatic plants), grasses, residues, and fibers.

The credit is available for property placed in service prior to January 1, 2014. The maximum credit for a taxpayer for all taxable years is \$500, and no more than \$200 of such credit may be attributable to expenditures on windows.

The taxpayer's basis in the property is reduced by the amount of the credit. Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations. If less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account.

For purposes of determining the amount of expenditures made by any individual with respect to any dwelling unit, expenditures which are made from subsidized energy financing are not taken into account. The term "subsidized energy financing" means financing provided under a Federal, State, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.

### ***Explanation of Provision***

The provision extends the credit for one year, through December 31, 2014.

### ***Effective Date***

The provision is effective for property placed in service after December 31, 2013.

<sup>536</sup> These standards are a seasonal energy efficiency ratio ("SEER") greater than or equal to 15, an energy efficiency ratio ("EER") greater than or equal to 12.5, and heating seasonal performance factor ("HSPF") greater than or equal to 8.5 for split heat pumps, and SEER greater than or equal to 14, EER greater than or equal to 12, and HSPF greater than or equal to 8.0 for packaged heat pumps.

<sup>537</sup> These standards are a SEER greater than or equal to 16 and EER greater than or equal to 13 for split systems, and SEER greater than or equal to 14 and EER greater than or equal to 12 for packaged systems.

## **2. Extension of second generation biofuel producer credit (sec. 152 of the Act and sec. 40(b)(6) of the Code)**

### ***Present Law***

The second generation biofuel producer credit is a nonrefundable income tax credit for each gallon of qualified second generation biofuel production of the producer for the taxable year. The amount of the credit per gallon is \$1.01. The provision does not apply to fuel sold or used after December 31, 2013.

“Qualified second generation biofuel production” is any second generation biofuel which is produced by the taxpayer and which, during the taxable year, is: (1) sold by the taxpayer to another person (a) for use by such other person in the production of a qualified second generation biofuel mixture in such person’s trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or (c) who sells such second generation biofuel at retail to another person and places such cellulosic biofuel in the fuel tank of such other person; or (2) used by the producer for any purpose described in (1)(a), (b), or (c).<sup>538</sup> Special rules apply for fuel derived from algae.

“Second generation biofuel” means any liquid fuel that (1) is produced in the United States and used as fuel in the United States, (2) is derived by or from qualified feedstocks and (3) meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency (“EPA”) under section 211 of the Clean Air Act. “Qualified feedstock” means any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis, and any cultivated algae, cyanobacteria or lemna. Second generation biofuel does not include fuels that (1) are more than four percent (determined by weight) water and sediment in any combination, (2) have an ash content of more than one percent (determined by weight), or (3) have an acid number greater than 25 (“unprocessed or excluded fuels”). It also does not include any alcohol with a proof of less than 150.

The second generation biofuel producer credit cannot be claimed unless the taxpayer is registered by the Internal Revenue Service (“IRS”) as a producer of second generation biofuel. Second generation biofuel eligible for the section 40 credit is precluded from qualifying as biodiesel, renewable diesel, or alternative fuel for purposes of the applicable income tax credit, excise tax credit, or payment provisions relating to those fuels.

Because it is a credit under section 40(a), the second generation biofuel producer credit is part of the general business credits in section 38. However, the credit can only be carried forward three taxable years after the termination of the credit. The credit is also allowable against the alternative minimum tax. Under section 87, the credit is included in gross income.

<sup>538</sup> In addition, for fuels derived from algae, cyanobacterial or lemna, a special rule provides that qualified second generation biofuel includes fuel that is sold by the taxpayer to another person for refining by such other person into a fuel that meets the registration requirements for fuels and fuel additives under section 211 of the Clean Air Act.

### ***Explanation of Provision***

The provision extends the credit for one year, through December 31, 2014.

### ***Effective Date***

The provision is effective for qualified second generation biofuel production after December 31, 2013.

### **3. Extension of incentives for biodiesel and renewable diesel (secs. 153 of the Act and secs. 40A, 6426 and 6427(e) of the Code)**

#### ***Present Law***

##### ***Biodiesel***

Present law provides an income tax credit for biodiesel fuels (the “biodiesel fuels credit”).<sup>539</sup> The biodiesel fuels credit is the sum of three credits: (1) the biodiesel mixture credit, (2) the biodiesel credit, and (3) the small agri-biodiesel producer credit. The biodiesel fuels credit is treated as a general business credit. The amount of the biodiesel fuels credit is includible in gross income. The biodiesel fuels credit is coordinated to take into account benefits from the biodiesel excise tax credit and payment provisions discussed below. The credit does not apply to fuel sold or used after December 31, 2013.

Biodiesel is monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet (1) the registration requirements established by the EPA under section 211 of the Clean Air Act (42 U.S.C. sec. 7545) and (2) the requirements of the American Society of Testing and Materials (“ASTM”) D6751. Agri-biodiesel is biodiesel derived solely from virgin oils including oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, camelina, or animal fats.

Biodiesel may be taken into account for purposes of the credit only if the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer or importer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.

##### ***Biodiesel mixture credit***

The biodiesel mixture credit is \$1.00 for each gallon of biodiesel (including agri-biodiesel) used by the taxpayer in the production of a qualified biodiesel mixture. A qualified biodiesel mixture is a mixture of biodiesel and diesel fuel that is (1) sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) used as a fuel by the taxpayer producing such mixture. The sale or use must be in the trade or business of the taxpayer and is to be taken into account for the taxable year in which such sale or use occurs. No credit is allowed with respect to any casual off-farm production of a qualified biodiesel mixture.

---

<sup>539</sup> Sec. 40A.

Per IRS guidance a mixture need only contain 1/10th of one percent of diesel fuel to be a qualified mixture.<sup>540</sup> Thus, a qualified biodiesel mixture can contain 99.9 percent biodiesel and 0.1 percent diesel fuel.

*Biodiesel credit (B-100)*

The biodiesel credit is \$1.00 for each gallon of biodiesel that is not in a mixture with diesel fuel (100 percent biodiesel or B-100) and which during the taxable year is (1) used by the taxpayer as a fuel in a trade or business or (2) sold by the taxpayer at retail to a person and placed in the fuel tank of such person's vehicle.

*Small agri-biodiesel producer credit*

The Code provides a small agri-biodiesel producer income tax credit, in addition to the biodiesel and biodiesel mixture credits. The credit is 10 cents per gallon for up to 15 million gallons of agri-biodiesel produced by small producers, defined generally as persons whose agri-biodiesel production capacity does not exceed 60 million gallons per year. The agri-biodiesel must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified biodiesel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such agri-biodiesel at retail to another person and places such agri-biodiesel in the fuel tank of such other person; or (2) used by the producer for any purpose described in (a), (b), or (c).

*Biodiesel mixture excise tax credit*

The Code also provides an excise tax credit for biodiesel mixtures.<sup>541</sup> The credit is \$1.00 for each gallon of biodiesel used by the taxpayer in producing a biodiesel mixture for sale or use in a trade or business of the taxpayer. A biodiesel mixture is a mixture of biodiesel and diesel fuel that (1) is sold by the taxpayer producing such mixture to any person for use as a fuel or (2) is used as a fuel by the taxpayer producing such mixture. No credit is allowed unless the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.<sup>542</sup>

The credit is not available for any sale or use for any period after December 31, 2013. This excise tax credit is coordinated with the income tax credit for biodiesel such that credit for the same biodiesel cannot be claimed for both income and excise tax purposes.

*Payments with respect to biodiesel fuel mixtures*

If any person produces a biodiesel fuel mixture in such person's trade or business, the Secretary is to pay such person an amount equal to the biodiesel mixture credit.<sup>543</sup> The biodiesel fuel mixture credit must first be taken against tax liability for taxable fuels. To

<sup>540</sup> Notice 2005-62, I.R.B. 2005-35, 443 (2005). "A biodiesel mixture is a mixture of biodiesel and diesel fuel containing at least 0.1 percent (by volume) of diesel fuel. Thus, for example, a mixture of 999 gallons of biodiesel and 1 gallon of diesel fuel is a biodiesel mixture."

<sup>541</sup> Sec. 6426(c).

<sup>542</sup> Sec. 6426(c)(4).

<sup>543</sup> Sec. 6427(e).

the extent the biodiesel fuel mixture credit exceeds such tax liability, the excess may be received as a payment. Thus, if the person has no section 4081 liability, the credit is refundable. The Secretary is not required to make payments with respect to biodiesel fuel mixtures sold or used after December 31, 2013.

### ***Renewable diesel***

“Renewable diesel” is liquid fuel that (1) is derived from biomass (as defined in section 45K(c)(3)), (2) meets the registration requirements for fuels and fuel additives established by the EPA under section 211 of the Clean Air Act, and (3) meets the requirements of the ASTM D975 or D396, or equivalent standard established by the Secretary. ASTM D975 provides standards for diesel fuel suitable for use in diesel engines. ASTM D396 provides standards for fuel oil intended for use in fuel-oil burning equipment, such as furnaces. Renewable diesel also includes fuel derived from biomass that meets the requirements of a Department of Defense specification for military jet fuel or an ASTM specification for aviation turbine fuel.

For purposes of the Code, renewable diesel is generally treated the same as biodiesel. In the case of renewable diesel that is aviation fuel, kerosene is treated as though it were diesel fuel for purposes of a qualified renewable diesel mixture. Like biodiesel, the incentive may be taken as an income tax credit, an excise tax credit, or as a payment from the Secretary.<sup>544</sup> The incentive for renewable diesel is \$1.00 per gallon. There is no small producer credit for renewable diesel. The incentives for renewable diesel expired after December 31, 2013.

### ***Explanation of Provision***

The provision extends the income tax credit, excise tax credit and payment provisions for biodiesel and renewable diesel for one year, through December 31, 2014.

In light of the retroactive nature of the provision, as it relates to fuel sold or used in 2014, the provision creates a special rule to address claims regarding excise credits and claims for payment associated with periods occurring during 2014. In particular the provision directs the Secretary to issue guidance within 30 days of the date of enactment. Such guidance is to provide for a one-time submission of claims covering periods occurring during 2014. The guidance is to provide for a 180-day period for the submission of such claims (in such manner as prescribed by the Secretary) to begin no later than 30 days after such guidance is issued.<sup>545</sup> Such claims shall be paid by the Secretary of the Treasury not later than 60 days after receipt. If the claim is not paid within 60 days of the date of the filing, the claim shall be paid with interest from such date determined by using the overpayment rate and method under section 6621 of the Code.

<sup>544</sup> Secs. 40A(f), 6426(c), and 6427(e).

<sup>545</sup> This guidance is provided by Notice 2015-3, 2015-6 I.R.B 583.

*Effective Date*

The provision is effective for fuel sold or used after December 31, 2013.

**4. Extension of credit for the production of Indian coal facilities placed in service before 2009 (sec. 154 of the Act and sec. 45(e)(10) of the Code)**

*Present Law*

A credit is available for the production of Indian coal sold to an unrelated third party from a qualified facility for a seven-year period beginning January 1, 2006, and ending December 31, 2013. The amount of the credit for Indian coal is \$1.50 per ton for the first four years of the seven-year period and \$2.00 per ton for the last three years of the seven-year period. Beginning in calendar years after 2006, the credit amounts are indexed annually for inflation using 2005 as the base year. The credit amount for 2014 is \$2.317 per ton.

A qualified Indian coal facility is a facility placed in service before January 1, 2009, that produces coal from reserves that on June 14, 2005, were owned by a Federally recognized tribe of Indians or were held in trust by the United States for a tribe or its members.

The credit is a component of the general business credit,<sup>546</sup> allowing excess credits to be carried back one year and forward up to 20 years. The credit is also subject to the alternative minimum tax.

*Explanation of Provision*

The provision extends the credit for the production of Indian coal for one year (through December 31, 2014).

*Effective Date*

The provision is effective for Indian coal produced after December 31, 2013.

**5. Extension of credits with respect to facilities producing energy from certain renewable resources (sec. 155 of the Act and secs. 45 and 48 of the Code)**

*Present Law**Renewable electricity production credit*

An income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities (the “renewable electricity production credit”).<sup>547</sup> Qualified energy resources comprise wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. Qualified facilities are, generally, facilities that

<sup>546</sup> Sec. 38(b)(8).

<sup>547</sup> Sec. 45. In addition to the renewable electricity production credit, section 45 also provides income tax credits for the production of Indian coal and refined coal at qualified facilities.

generate electricity using qualified energy resources. To be eligible for the credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person.

#### SUMMARY OF CREDIT FOR ELECTRICITY PRODUCED FROM CERTAIN RENEWABLE RESOURCES

Eligible electricity production activity (sec. 45)	Credit amount for 2014 <sup>1</sup> (cents per kilowatt-hour)	Expiration <sup>2</sup>
Wind .....	2.3	December 31, 2013
Closed-loop biomass .....	2.3	December 31, 2013
Open-loop biomass (including agricultural livestock waste nutrient facilities) .....	1.1	December 31, 2013
Geothermal .....	2.3	December 31, 2013
Solar (pre-2006 facilities only) .....	2.3	December 31, 2005
Small irrigation power .....	1.1	December 31, 2013
Municipal solid waste (including landfill gas facilities and trash combustion facilities) .....	1.1	December 31, 2013
Qualified hydropower .....	1.1	December 31, 2013
Marine and hydrokinetic .....	1.1	December 31, 2013

<sup>1</sup> In general, the credit is available for electricity produced during the first 10 years after a facility has been placed in service.

<sup>2</sup> Expires for property the construction of which begins after this date.

#### ***Election to claim energy credit in lieu of renewable electricity production credit***

A taxpayer may make an irrevocable election to have certain property which is part of a qualified renewable electricity production facility be treated as energy property eligible for a 30 percent investment credit under section 48. For this purpose, qualified facilities are facilities otherwise eligible for the renewable electricity production credit with respect to which no credit under section 45 has been allowed. A taxpayer electing to treat a facility as energy property may not claim the renewable electricity production credit. The eligible basis for the investment credit for taxpayers making this election is the basis of the depreciable (or amortizable) property that is part of a facility capable of generating electricity eligible for the renewable electricity production credit.

#### ***Explanation of Provision***

The provision extends the renewable electricity production credit and the election to claim the energy credit in lieu of the electricity production credit for one year, through December 31, 2014.

#### ***Effective Date***

The provision is effective on January 1, 2014.

#### **6. Extension of credit for energy-efficient new homes (sec. 156 of the Act and sec. 45L of the Code)**

#### ***Present Law***

Present law provides a credit to an eligible contractor for each qualified new energy-efficient home that is constructed by the eligible contractor and acquired by a person from such eligible contractor for use as a residence during the taxable year. To qualify as a new energy-efficient home, the home must be: (1) a dwelling

located in the United States, (2) substantially completed after August 8, 2005, and (3) certified in accordance with guidance prescribed by the Secretary to have a projected level of annual heating and cooling energy consumption that meets the standards for either a 30-percent or 50-percent reduction in energy usage, compared to a comparable dwelling constructed in accordance with the standards of chapter 4 of the 2006 International Energy Conservation Code as in effect (including supplements) on January 1, 2006, and any applicable Federal minimum efficiency standards for equipment. With respect to homes that meet the 30-percent standard, one-third of such 30-percent savings must come from the building envelope, and with respect to homes that meet the 50-percent standard, one-fifth of such 50-percent savings must come from the building envelope.

Manufactured homes that conform to Federal manufactured home construction and safety standards are eligible for the credit provided all the criteria for the credit are met. The eligible contractor is the person who constructed the home, or in the case of a manufactured home, the producer of such home.

The credit equals \$1,000 in the case of a new home that meets the 30-percent standard and \$2,000 in the case of a new home that meets the 50-percent standard. Only manufactured homes are eligible for the \$1,000 credit.

In lieu of meeting the standards of chapter 4 of the 2006 International Energy Conservation Code, manufactured homes certified by a method prescribed by the Administrator of the Environmental Protection Agency under the Energy Star Labeled Homes program are eligible for the \$1,000 credit provided criteria (1) and (2), above, are met.

The credit applies to homes that are acquired prior to January 1, 2014. The credit is part of the general business credit.

#### ***Explanation of Provision***

The provision extends the credit for one year for homes that are acquired prior to January 1, 2015.

#### ***Effective Date***

The provision is effective for homes acquired after December 31, 2013.

### **7. Extension of special allowance for second generation biofuel plant property (sec. 157 of the Act and sec. 168(l) of the Code)**

#### ***Present Law***

Present law<sup>548</sup> allows an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified second generation biofuel plant property. In order to qualify, the property generally must be placed in service before January 1, 2014.<sup>549</sup>

Qualified second generation biofuel plant property means depreciable property used in the U.S. solely to produce any liquid fuel

<sup>548</sup> Sec. 168(l).

<sup>549</sup> Sec. 168(l)(2)(D).



that (1) is derived from qualified feedstocks, and (2) meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency (“EPA”) under section 211 of the Clean Air Act.<sup>550</sup> Qualified feedstocks means any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis<sup>551</sup> and any cultivated algae, cyanobacteria, or lemna.<sup>552</sup> Second generation biofuel does not include any alcohol with a proof of less than 150 or certain unprocessed fuel.<sup>553</sup> Unprocessed fuels are fuels that (1) are more than four percent (determined by weight) water and sediment in any combination, (2) have an ash content of more than one percent (determined by weight), or (3) have an acid number greater than 25.<sup>554</sup>

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service.<sup>555</sup> The additional first-year depreciation deduction is subject to the general rules regarding whether an item is subject to capitalization under section 263A. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction.<sup>556</sup> In addition, there is no adjustment to the allowable amount of depreciation for purposes of computing a taxpayer’s alternative minimum taxable income with respect to property to which the provision applies.<sup>557</sup> A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.<sup>558</sup>

In order for property to qualify for the additional first-year depreciation deduction, it must meet the following requirements: (1) the original use of the property must commence with the taxpayer on or after December 20, 2006; and (2) the property must be (i) acquired by purchase (as defined under section 179(d)) by the taxpayer after December 20, 2006, and (ii) placed in service before January 1, 2014.<sup>559</sup> Property does not qualify if a binding written contract for the acquisition of such property was in effect on or before December 20, 2006.

Property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the property after December 20, 2006, and the property is placed in service before January 1, 2014 (and all other requirements are met).<sup>560</sup> Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

<sup>550</sup> Secs. 168(l)(2)(A) and 40(b)(6)(E).

<sup>551</sup> For example, lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis includes bagasse (from sugar cane), corn stalks, and switchgrass.

<sup>552</sup> Sec. 40(b)(6)(F).

<sup>553</sup> Sec. 40(b)(6)(E)(ii) and (iii).

<sup>554</sup> Sec. 40(b)(6)(E)(iii).

<sup>555</sup> Sec. 168(l)(5).

<sup>556</sup> Sec. 168(l)(1)(B).

<sup>557</sup> Sec. 168(l)(5) and 168(k)(2)(G).

<sup>558</sup> Sec. 168(l)(3)(D).

<sup>559</sup> Sec. 168(l)(2).

<sup>560</sup> Sec. 168(l)(4) and 168(k)(2)(E).

Property any portion of which is financed with the proceeds of a tax-exempt obligation under section 103 is not eligible for the additional first-year depreciation deduction.<sup>561</sup> Recapture rules apply if the property ceases to be qualified second generation biofuel plant property.<sup>562</sup>

Property with respect to which the taxpayer has elected 50 percent expensing under section 179C is not eligible for the additional first-year depreciation deduction.<sup>563</sup>

### ***Explanation of Provision***

The provision extends the present law special depreciation allowance for one year, to qualified second generation biofuel plant property placed in service prior to January 1, 2015.

### ***Effective Date***

The provision applies to property placed in service after December 31, 2013.

## **8. Extension of energy efficient commercial buildings deduction (sec. 158 of the Act and sec. 179D of the Code)**

### ***Present Law***

#### ***In general***

Code section 179D provides an election under which a taxpayer may take an immediate deduction equal to energy-efficient commercial building property expenditures made by the taxpayer. Energy-efficient commercial building property is defined as property (1) which is installed on or in any building located in the United States that is within the scope of Standard 90.1–2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America (“ASHRAE/IESNA”), (2) which is installed as part of (i) the interior lighting systems, (ii) the heating, cooling, ventilation, and hot water systems, or (iii) the building envelope, and (3) which is certified as being installed as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of the building by 50 percent or more in comparison to a reference building which meets the minimum requirements of Standard 90.1–2001 (as in effect on April 2, 2003). The deduction is limited to an amount equal to \$1.80 per square foot of the property for which such expenditures are made. The deduction is allowed in the year in which the property is placed in service.

Certain certification requirements must be met in order to qualify for the deduction. The Secretary, in consultation with the Secretary of Energy, will promulgate regulations that describe methods of calculating and verifying energy and power costs using qualified computer software based on the provisions of the 2005 California Nonresidential Alternative Calculation Method Approval

<sup>561</sup> Sec. 168(l)(3)(C).

<sup>562</sup> Sec. 168(l)(6).

<sup>563</sup> Sec. 168(l)(7).

Manual or, in the case of residential property, the 2005 California Residential Alternative Calculation Method Approval Manual.

The Secretary is granted authority to prescribe procedures for the inspection and testing for compliance of buildings that are comparable, given the difference between commercial and residential buildings, to the requirements in the Mortgage Industry National Accreditation Procedures for Home Energy Rating Systems.<sup>564</sup> Individuals qualified to determine compliance shall only be those recognized by one or more organizations certified by the Secretary for such purposes.

For energy-efficient commercial building property expenditures made by a public entity, such as public schools, the deduction may be allocated to the person primarily responsible for designing the property in lieu of the public entity.

If a deduction is allowed under this section, the basis of the property is reduced by the amount of the deduction.

The deduction is effective for property placed in service prior to January 1, 2014.

### ***Partial allowance of deduction***

#### *System-specific deductions*

In the case of a building that does not meet the overall building requirement of 50-percent energy savings, a partial deduction is allowed with respect to each separate building system that comprises energy efficient property and which is certified by a qualified professional as meeting or exceeding the applicable system-specific savings targets established by the Secretary. The applicable system-specific savings targets to be established by the Secretary are those that would result in a total annual energy savings with respect to the whole building of 50 percent, if each of the separate systems met the system specific target. The separate building systems are (1) the interior lighting system, (2) the heating, cooling, ventilation and hot water systems, and (3) the building envelope. The maximum allowable deduction is \$0.60 per square foot for each separate system.

#### *Interim rules for lighting systems*

In general, in the case of system-specific partial deductions, no deduction is allowed until the Secretary establishes system-specific targets.<sup>565</sup> However, in the case of lighting system retrofits, until such time as the Secretary issues final regulations, the system-specific energy savings target for the lighting system is deemed to be met by a reduction in lighting power density of 40 percent (50 percent in the case of a warehouse) of the minimum requirements in Table 9.3.1.1 or Table 9.3.1.2 of ASHRAE/IESNA Standard 90.1–

<sup>564</sup> See IRS Notice 2006–52, 2006–1 C.B. 1175, June 2, 2006; IRS 2008–40, 2008–14 I.R.B. 725 March 11, 2008.

<sup>565</sup> IRS Notice 2008–40, *supra*, set a target of a 10-percent reduction in total energy and power costs with respect to the building envelope, and 20 percent each with respect to the interior lighting system and the heating, cooling, ventilation and hot water systems. IRS Notice 2012–26 (2012–17 I.R.B. 847 April 23, 2012) established new targets of 10-percent reduction in total energy and power costs with respect to the building envelope, 25 percent with respect to the interior lighting system and 15 percent with respect to the heating, cooling, ventilation and hot water systems, effective beginning March 12, 2012. The targets from Notice 2008–40 may continue to be used until December 31, 2013, but only the new targets of Notice 2012–26 will be available under any extension of section 179D beyond December 31, 2013.

2001. Also, in the case of a lighting system that reduces lighting power density by 25 percent, a partial deduction of 30 cents per square foot is allowed. A pro-rated partial deduction is allowed in the case of a lighting system that reduces lighting power density between 25 percent and 40 percent. Certain lighting level and lighting control requirements must also be met in order to qualify for the partial lighting deductions under the interim rule.

### ***Explanation of Provision***

The provision extends the deduction for one year, through December 31, 2014.

### ***Effective Date***

The provision applies to property placed in service after December 31, 2013.

## **9. Extension of special rule for sales or dispositions to implement FERC or State electric restructuring policy for qualified electric utilities (sec. 159 of the Act and sec. 451(i) of the Code)**

### ***Present Law***

A taxpayer selling property generally realizes gain to the extent the sales price (and any other consideration received) exceeds the taxpayer's basis in the property.<sup>566</sup> The realized gain is subject to current income tax<sup>567</sup> unless the recognition of the gain is deferred or excluded from income under a special tax provision.<sup>568</sup>

One such special tax provision permits taxpayers to elect to recognize gain from qualifying electric transmission transactions ratably over an eight-year period beginning in the year of sale if the amount realized from such sale is used to purchase exempt utility property within the applicable period<sup>569</sup> (the "reinvestment property").<sup>570</sup> If the amount realized exceeds the amount used to purchase reinvestment property, any realized gain is recognized to the extent of such excess in the year of the qualifying electric transmission transaction.

A qualifying electric transmission transaction is the sale or other disposition of property used by a qualified electric utility to an independent transmission company prior to January 1, 2014.<sup>571</sup> A qualified electric utility is defined as an electric utility, which as of the date of the qualifying electric transmission transaction, is vertically integrated in that it is both (1) a transmitting utility (as defined in the Federal Power Act)<sup>572</sup> with respect to the trans-

<sup>566</sup> See sec. 1001.

<sup>567</sup> See secs. 61 and 451.

<sup>568</sup> See, e.g., secs. 453, 1031 and 1033.

<sup>569</sup> The applicable period for a taxpayer to reinvest the proceeds is four years after the close of the taxable year in which the qualifying electric transmission transaction occurs.

<sup>570</sup> Sec. 451(i).

<sup>571</sup> Sec. 451(i)(3).

<sup>572</sup> Sec. 3(23), 16 U.S.C. sec. 796, defines "transmitting utility" as any electric utility, qualifying cogeneration facility, qualifying small power production facility, or Federal power marketing agency that owns or operates electric power transmission facilities that are used for the sale of electric energy at wholesale.

mission facilities to which the election applies, and (2) an electric utility (as defined in the Federal Power Act<sup>573</sup>).<sup>574</sup>

In general, an independent transmission company is defined as: (1) an independent transmission provider<sup>575</sup> approved by the Federal Energy Regulatory Commission (“FERC”); (2) a person (i) who the FERC determines under section 203 of the Federal Power Act<sup>576</sup> (or by declaratory order) is not a “market participant” and (ii) whose transmission facilities are placed under the operational control of a FERC-approved independent transmission provider no later than four years after the close of the taxable year in which the transaction occurs; or (3) in the case of facilities subject to the jurisdiction of the Public Utility Commission of Texas, (i) a person which is approved by that Commission as consistent with Texas State law regarding an independent transmission organization, or (ii) a political subdivision, or affiliate thereof, whose transmission facilities are under the operational control of an organization described in (i).<sup>577</sup>

Exempt utility property is defined as: (1) property used in the trade or business of (i) generating, transmitting, distributing, or selling electricity or (ii) producing, transmitting, distributing, or selling natural gas; or (2) stock in a controlled corporation whose principal trade or business consists of the activities described in (1).<sup>578</sup> Exempt utility property does not include any property that is located outside of the United States.<sup>579</sup>

If a taxpayer is a member of an affiliated group of corporations filing a consolidated return, the reinvestment property may be purchased by any member of the affiliated group (in lieu of the taxpayer).<sup>580</sup>

### ***Explanation of Provision***

The provision extends for one year the treatment under the present-law deferral provision to sales or dispositions by a qualified electric utility that occur prior to January 1, 2015.

### ***Effective Date***

The provision applies to dispositions after December 31, 2013.

<sup>573</sup> Sec. 3(22), 16 U.S.C. sec. 796, defines “electric utility” as any person or State agency (including any municipality) that sells electric energy; such term includes the Tennessee Valley Authority, but does not include any Federal power marketing agency.

<sup>574</sup> Sec. 451(i)(6).

<sup>575</sup> For example, a regional transmission organization, an independent system operator, or an independent transmission company.

<sup>576</sup> 16 U.S.C. sec. 824b.

<sup>577</sup> Sec. 451(i)(4).

<sup>578</sup> Sec. 451(i)(5).

<sup>579</sup> Sec. 451(i)(5)(C).

<sup>580</sup> Sec. 451(i)(7).

**10. Extension of excise tax credits relating to certain fuels (sec. 160 of the Act and sec. 6426 and 6427(e) of the Code)**

***Present Law***

***Fuel excise taxes***

Fuel excise taxes are imposed on taxable fuel (gasoline, diesel fuel or kerosene) under section 4081. In general, these fuels are taxed when removed from a refinery, terminal rack, upon entry into the United States, or upon sale to an unregistered person. A back-up tax under section 4041 is imposed on previously untaxed fuel and alternative fuel used or sold for use as fuel in a motor vehicle or motorboat to the supply tank of a highway vehicle. In general, the rates of tax are 18.3 cents per gallon (or in the case of compressed natural gas 18.3 cents per gasoline gallon equivalent), and in the case of liquefied natural gas, and liquid fuel derived from coal or biomass, 24.3 cents per gallon.

***Alternative fuel and alternative fuel mixture credits and payments***

The Code provides two per-gallon excise tax credits with respect to alternative fuel: the alternative fuel credit, and the alternative fuel mixture credit. For this purpose, the term “alternative fuel” means liquefied petroleum gas, P Series fuels (as defined by the Secretary of Energy under 42 U.S.C. sec. 13211(2)), compressed or liquefied natural gas, liquefied hydrogen, liquid fuel derived from coal through the Fischer-Tropsch process (“coal-to-liquids”), compressed or liquefied gas derived from biomass, or liquid fuel derived from biomass. Such term does not include ethanol, methanol, or biodiesel.

For coal-to-liquids produced after December 30, 2009, the fuel must be certified as having been derived from coal produced at a gasification facility that separates and sequesters 75 percent of such facility’s total carbon dioxide emissions.

The alternative fuel credit is allowed against section 4041 liability, and the alternative fuel mixture credit is allowed against section 4081 liability. Neither credit is allowed unless the taxpayer is registered with the Secretary. The alternative fuel credit is 50 cents per gallon of alternative fuel or gasoline gallon equivalents<sup>581</sup> of nonliquid alternative fuel sold by the taxpayer for use as a motor fuel in a motor vehicle or motorboat, sold for use in aviation or so used by the taxpayer.

The alternative fuel mixture credit is 50 cents per gallon of alternative fuel used in producing an alternative fuel mixture for sale or use in a trade or business of the taxpayer. An “alternative fuel mixture” is a mixture of alternative fuel and taxable fuel (gasoline, diesel fuel or kerosene) that contains at least 1/10 of one percent taxable fuel. The mixture must be sold by the taxpayer producing such mixture to any person for use as a fuel, or used by the tax-

<sup>581</sup> “Gasoline gallon equivalent” means, with respect to any nonliquid alternative fuel (for example, compressed natural gas), the amount of such fuel having a Btu (British thermal unit) content of 124,800 (higher heating value).

payer producing the mixture as a fuel. The credits expired after December 31, 2013 (September 30, 2014 for liquefied hydrogen).

A person may file a claim for payment equal to the amount of the alternative fuel credit (but not the alternative fuel mixture credit). The alternative fuel credit must first be applied to the applicable excise tax liability under section 4041 or 4081, and any excess credit may be taken as a payment. These payment provisions generally also expire after December 31, 2013. With respect to liquefied hydrogen, the payment provisions expire after September 30, 2014.

For purposes of the alternative fuel credit, alternative fuel mixture credit and related payment provisions, “alternative fuel” does not include fuel (including lignin, wood residues, or spent pulping liquors) derived from the production of paper or pulp.

### ***Explanation of Provision***

The provision extends the alternative fuel credit and related payment provisions, and the alternative fuel mixture credit through December 31, 2014 (including those related to liquefied hydrogen).

In light of the retroactive nature of the provision, as it relates to alternative fuel sold or used in 2014, the provision creates a special rule to address claims regarding excise credits and claims for payment associated with periods occurring during 2014. In particular the provision directs the Secretary to issue guidance within 30 days of the date of enactment. Such guidance is to provide for a one-time submission of claims covering periods occurring during 2014. The guidance is to provide for a 180-day period for the submission of such claims (in such manner as prescribed by the Secretary) to begin no later than 30 days after such guidance is issued.<sup>582</sup> Such claims shall be paid by the Secretary of the Treasury not later than 60 days after receipt. If the claim is not paid within 60 days of the date of the filing, the claim shall be paid with interest from such date determined by using the overpayment rate and method under section 6621 of such Code.

The provision, as it relates to biodiesel and renewable diesel, is described above in connection with section 153 of the Act “Incentives for Biodiesel and Renewable Diesel.”

### ***Effective Date***

The provision is generally effective for fuel sold or used after December 31, 2013. As it relates to liquefied hydrogen, the provision is effective for fuels sold or used after September 30, 2014.

## **11. Extension of credit for alternative fuel vehicle refueling property (sec. 161 of the Act and sec. 30C of the Code)**

### ***Present Law***

Taxpayers may claim a 30-percent credit for the cost of installing qualified clean-fuel vehicle refueling property to be used in a trade or business of the taxpayer or installed at the principal residence

<sup>582</sup> This guidance is provided by Notice 2015-3, 2015-6 I.R.B 583.

of the taxpayer.<sup>583</sup> The credit may not exceed \$30,000 per taxable year per location, in the case of qualified refueling property used in a trade or business and \$1,000 per taxable year per location, in the case of qualified refueling property installed on property which is used as a principal residence.

Qualified refueling property is property (not including a building or its structural components) for the storage or dispensing of a clean-burning fuel or electricity into the fuel tank or battery of a motor vehicle propelled by such fuel or electricity, but only if the storage or dispensing of the fuel or electricity is at the point of delivery into the fuel tank or battery of the motor vehicle. The original use of such property must begin with the taxpayer.

Clean-burning fuels are any fuel at least 85 percent of the volume of which consists of ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, or hydrogen. In addition, any mixture of biodiesel and diesel fuel, determined without regard to any use of kerosene and containing at least 20 percent biodiesel, qualifies as a clean fuel.

Credits for qualified refueling property used in a trade or business are part of the general business credit and may be carried back for one year and forward for 20 years. Credits for residential qualified refueling property cannot exceed for any taxable year the difference between the taxpayer's regular tax (reduced by certain other credits) and the taxpayer's tentative minimum tax. Generally, in the case of qualified refueling property sold to a tax-exempt entity, the taxpayer selling the property may claim the credit.

A taxpayer's basis in qualified refueling property is reduced by the amount of the credit. In addition, no credit is available for property used outside the United States or for which an election to expense has been made under section 179.

The credit is available for property placed in service after December 31, 2005, and (except in the case of hydrogen refueling property) before January 1, 2014. In the case of hydrogen refueling property, the property must be placed in service before January 1, 2015.

### ***Explanation of Provision***

The provision extends the 30-percent credit for alternative fuel refueling property (other than hydrogen refueling property which presently expires December 31, 2014) for one year, through December 31, 2014.

### ***Effective Date***

The provision is effective for property placed in service after December 31, 2013.

---

<sup>583</sup> Sec. 30C.



## **D. Subtitle D—Extenders Relating to Multiemployer Defined Benefit Pension Plans**

### **1. Multiemployer defined benefit plans (secs. 171–172 of the Act and sec. 221(c) of the Pension Protection Act of 2006, secs. 431–432 of the Code, and secs. 304–305 of ERISA)**

Certain provisions under the Pension Protection Act of 2006 relating to the funding rules for multiemployer defined benefit plans were scheduled to expire as of December 31, 2014 (“temporary multiemployer plan provisions”). The expiration dates for the temporary multiemployer plan provisions were repealed by the Multiemployer Pension Reform Act of 2014, thus making the multiemployer plan provisions permanent.<sup>584</sup>

Provisions of the Tax Increase Prevention Act of 2014 extended the expiration dates for the temporary multiemployer plan provisions for one year. However, because the expiration dates were earlier repealed by the Multiemployer Pension Reform Act of 2014, these provisions have no effect.

## **TITLE II—TECHNICAL CORRECTIONS**

### **A. Tax Technical Corrections**

#### **(secs. 201–220 of the Act)**

The Act includes technical corrections to recently enacted tax legislation. Except as otherwise provided, the amendments made by the technical corrections contained in the Act take effect as if included in the original legislation to which each amendment relates.

#### ***Amendments to the American Taxpayer Relief Act of 2012 (Pub. L. No. 112–240)***

**Phaseout of personal exemption amount for qualified disability trusts (Act sec. 101(b)).**—The provision corrects an obsolete statutory reference to the computation of the exemption amount for a qualified disability trust.

**Capital gain rate for certain high-income individuals (Act sec. 102).**—The provision contains a conforming amendment to the computation of the foreign earned income exclusion.

**Permanent alternative minimum tax relief for individuals (Act sec. 104).**—The provision clarifies that, as adjusted for inflation, the exemption amount for married individuals filing a separate return is one-half the exemption amount for married individuals filing a joint return. The provision also clarifies that the exemption amount for individuals filing a joint return, as adjusted for inflation, is rounded to the nearest \$100.

**Qualified zone academy bonds (Act sec. 310).**—The provision conforms the Code to Congressional intent that qualified zone academy bonds cannot be issued as direct-pay bonds using national limitation allocations from years after 2010 or carryforwards of such allocations.

<sup>584</sup> Sec. 101 of Division O of Pub. L. No. 113–235. The temporary multiemployer plan provisions and expiration dates, and repeal of the expiration dates, are described in Part Nine, Division O.A.1.

**Election to accelerate the AMT credit in lieu of bonus depreciation (Act sec. 331).**—The provision clarifies the taxable year for which an election under section 168(k)(4) is made.

***Amendment to the Middle Class Tax Relief and Job Creation Act of 2012 (Pub. L. No. 112–96)***

**Repeal of certain shifts in the timing of corporate estimated tax payments (Act sec. 7001).**—The provision corrects a reference to the repeal of certain shifts in the timing of estimated corporate taxes with respect to the Corporate Estimated Tax Shift Act of 2009 (Pub. L. No. 111–42).

***Amendment to the FAA Modernization and Reform Act of 2012 (Pub. L. No. 112–95)***

**Small aircraft on nonestablished lines (Act sec. 1107).**—Under Code section 4281, small aircraft (excluding jet aircraft) that are operated on nonestablished lines (e.g., for sightseeing) are exempt from the taxes imposed on the transportation of persons and property by air. The provision clarifies that rotorcraft (i.e., helicopters) and propeller aircraft are not “jet aircraft” for purposes of section 4281.

***Amendments to the Regulated Investment Company Modernization Act of 2010 (Pub. L. No. 111–325)***

**Capital loss carryovers (Act sec. 101).**—The Regulated Investment Company Modernization Act of 2010 provides capital loss carryover treatment for a regulated investment company (“RIC”) similar to the net capital loss carryovers applicable to individuals, effective for taxable years beginning after December 22, 2010. The Internal Revenue Service ruled that this provision is effective for purposes of the excise tax under section 4982 for calendar years after 2010.<sup>585</sup> Thus, this provision applies to 1-year periods beginning after October 31, 2010, which are taken into account in computing the excise tax for calendar years beginning after 2010.

The Act also provides that capital loss carryovers for taxable years beginning after December 22, 2010, are used prior to capital losses carryovers under the provisions of prior law. As a result of the interaction of these two provisions of the Act, there are situations where capital loss carryovers may expire for purposes of the excise tax but not for purposes of determining investment company taxable income.

The provision allows a RIC to elect to delay the new capital loss carryover provisions for purposes of section 4982 for one calendar year. For an electing RIC, the provision will apply to 1-year periods beginning after October 31, 2011, which are taken into account in computing the excise tax for calendar years beginning after 2011. The provision also provides that the capital loss carryovers of a RIC will not prevent the RIC from having sufficient earnings and profits to make the required distribution of its capital gain net income under section 4982 (as provided in section 852(c)(2)).

**Spillover dividends (Act sec. 304).**—The Act provides that a spillover dividend must be declared before the later of the 15th day

<sup>585</sup> Rev. Rul. 2012–29, 2012–42 I. R. B. 475.

of the 9th month following the close of the taxable year or the extended due date for filing the return for the taxable year. The provision provides the declaration may be made on or before the relevant date.

**Certain late year losses (Act sec. 308).**—Under the law in effect both before and after enactment the Act, the amount which may be treated as a capital gain dividend for a taxable year of a RIC is determined without regard to the post-October capital loss for the year, and the post-October capital loss is treated as arising on the first day of the next taxable year. Under the law in effect before enactment of the Act, the term “post-October capital loss” was defined as any net capital loss attributable to the portion of the taxable year after October 31, or if there was no net capital loss, any net-long term capital loss attributable to the portion of the taxable year after that date.<sup>586</sup> Under the Act, the term “post-October capital loss” is the greatest of (i) the net capital loss attributable to the portion of the taxable year after October 31, (ii) the net-long term capital loss attributable to the portion of the taxable year after that date, or (iii) the net-short term capital loss attributable to the portion of the taxable year after that date.

Under the provision, the term “post-October capital loss” is the net capital loss attributable to the portion of the taxable year after October 31, or if there is no net capital loss, any net long-term capital loss or any net short-term capital loss attributable to the portion of the taxable year after that date.

Under the law in effect before enactment of the Act, to the extent provided in regulations, a RIC could elect to push the post-October net foreign currency losses and the net reduction in the value of stock in a PFIC (passive foreign investment company) with respect to which an election is in effect under section 1296(k) forward to the next taxable year. Regulations had been issued allowing RICs to elect to defer all or part of any post-October net foreign currency losses for the portion of the taxable year after October 31 to the first day of the succeeding taxable year. The Act expanded this rule to provide that any late-year ordinary loss may be deferred.

The provision corrects the definition of late-year ordinary loss by defining the loss to be the sum of the post-October specified loss (if any) and the post-December ordinary loss (if any).

In the case of an election by a RIC with respect to a taxable year beginning before the date of enactment of this Act, the RIC may treat the amendments made by this provision as not applying with respect to any such election.

**Deferral of certain gains and losses for excise tax purposes (Act sec. 402).**—For purposes of the section 4982 excise tax, the Act applies the mark to market provisions of the Code and regulations thereunder as if the taxable year ended on October 31. Also, the Act allows a taxable year RIC, except as provided in regulations, to elect to “push” any net ordinary loss (determined without regard to ordinary gains and losses that are automatically “pushed” to the next calendar year) attributable to the portion of

<sup>586</sup>Treas. Reg. sec. 1.852-11. Also, Notice 97-64, 1997-2 C.B. 323, provides guidance on the application of the multiple tax rates under section 1(h) to capital gain dividends of RICs.

the calendar year after the beginning of the taxable year that begins in the calendar year to the first day of the next calendar year.

The provision provides that any rule that determines income by reference to the value of an item on the last day of the taxable year is treated as a mark to market provision for which value will be determined on October 31 for purposes of the excise tax.

The provision allows a RIC to elect to push any portion of a net ordinary loss to the next calendar year in determining its ordinary income or net ordinary loss for a calendar year.

***Amendments to the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub. L. No. 111-312)***

**Indexing of amount of reduction of marriage penalty for earned income credit (Act sec. 103).**—The earned income tax credit in section 32 of the Code is clarified to provide that the \$5,000 amount, by which the phase-out thresholds for married couples filing jointly are increased, is indexed for inflation for all taxable years after 2009, not just taxable years beginning in 2010.

**Nonrecognition of gain on rollover of empowerment zone investments (Act sec. 753).**—Code section 1397B provides that taxpayers can elect to defer recognition of gain on the sale of a qualified empowerment zone asset held for more than one year and replaced within 60 days by another qualified empowerment zone asset in the same zone. The provision clarifies that Code section 1397B applies to qualified empowerment zone assets acquired during the period the empowerment zone designation is in effect.

***Amendments to the Creating Small Business Jobs Act of 2010 (Pub. L. No. 111-240)***

**Failure to furnish correct payee statements (Act sec. 2102).**—The provision clarifies that the effective date for the amendments to both Code sections 6721 and 6722 applies with respect to both information returns required to be filed and payee statements required to be furnished on or after January 1, 2011.

Amendments to the American Recovery and Reinvestment Act of 2009, Division B (Pub. L. No. 111-5)

**Refundable portion of child credit for certain taxable years (Act sec. 1003).**—The child tax credit in section 24 of the Code is clarified regarding the determination of the refundable credit in any taxable years beginning after 2008 and before 2018. The provision provides that, to the extent that the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit equal to 15 percent of earned income in excess of \$3,000 not indexed for inflation (in lieu of \$10,000 indexed for inflation). The present-law alternative formula for families with three or more children is unchanged.

**American Opportunity Tax Credit (Act sec. 1004).**—The Act includes a reference to "tuition, fees, and course materials." The reference to course materials was intended to apply to the Hope credit, but not to the Lifetime learning credit. The provision corrects this reference to the inclusion of course materials so that it applies only to the Hope credit and not to the Lifetime learning credit.

**Deduction for State sales tax and excise tax on the purchase of certain motor vehicles (Act sec. 1008).**—The Act provides an itemized deduction and increased standard deduction for qualified motor vehicle taxes. The provision strikes Code section 164(b)(6)(E) (which refers to the last sentence of section 164(a)) as inoperative, because the taxes referred to in that last sentence do not include qualified motor vehicle taxes.

**Coordination with renewable energy grants (Act sec. 1104).**—The provision provides that grants in lieu of energy credits under section 1603 of the Act are not includible in alternative minimum taxable income (including adjusted current earnings of a corporation). This treatment is consistent with the treatment of energy credits.

**Credits for certain vehicles and refueling property (Act secs. 1141 and 1142, and secs. 1341 and 1342 of the Energy Tax Incentives Act of 2005 (Pub. L. No. 109–58)).**—The provisions conform the rules relating to the amount of basis reduction, as well as the reduction of other credits and deductions, on account of the credits for certain vehicles and refueling property under sections 30, 30B, 30C, and 30D of the Code.

**Qualifying advanced energy project credit (Act sec. 1302).**—The provision restores missing words, clarifying that the amount subject to the limitation in Code section 48C(b)(3) is the amount that is treated as the qualified investment.

**Regulated investment companies allowed to pass through tax credit bond credits (Act sec. 1541).**—The provision clarifies that a regulated investment company electing to pass through credits on tax credit bonds, and its shareholders, are treated in a manner similar to that which would occur if the company distributed to its shareholders an amount of money equal to the amount of the credits passed through.

**Special credit for certain government retirees (Act sec. 2202).**—The provision clarifies the credit with respect to treatment of the U.S. possessions. The provision is intended to operate in a manner similar to the operation of the Making Work Pay Credit with respect to the U.S. possessions (see H.R. Rep. 111–16, February 12, 2009, at 516–517).

***Amendments to the Emergency Economic Stabilization Act of 2008 (Pub. L. No 110–343)***

*Division B, the Energy Improvement and Extension Act of 2008*

**Credit for steel industry fuel (Act Div. B sec. 108).**—The provision clarifies that coke and coke gas produced using fuel qualifying for a steel industry fuel credit is not eligible for the credit under present-law section 45K(g).

**Temporary increase in coal excise tax; funding of Black Lung Disability Trust Fund (Act Div. B sec. 113).**—The provision clarifies that the term “trust fund” means the Black Lung Disability Trust Fund.

**Accelerated recovery period for depreciation of smart meters and smart grid systems (Act Div. B sec. 306).**—The provision clarifies that the accelerated recovery period for smart meters

and smart grid systems does not apply to property with a class life of less than 16 years.

**Special depreciation allowance for certain reuse and recycling property (Act Div. B sec. 308).**—Consistent with the intent of the Act, the provision clarifies that a taxpayer does not qualify for the special depreciation allowance under this provision if it elects out of bonus depreciation under Code section 168(k)(4), which permits a taxpayer to accelerate the recognition of AMT and research credits in lieu of claiming bonus depreciation. This conforms to the parallel rule in section 168(n)(2)(B)(i)(I) (excluding such property from the definition of qualified disaster assistance property) under the qualified disaster assistance property provisions.

**Special rules in case of foreign oil and gas income (Act Div. B sec. 402).**—The Act expands the foreign oil and gas extraction income (“FOGEI”) rules to apply to all foreign income from production and other activity related to the sale of oil and gas product (the sum of prior-law foreign oil-related income (“FORI”) and FOGEI). A transition rule in the Act unintentionally fails to properly apply pre-effective date law to pre-2009 credit carryforwards. The provision clarifies that pre-2009 credits carried forward to post-2008 years continue to be governed by prior law for purposes of determining the amount of carryforward credits eligible to be claimed in a post-2008 year.

**Broker reporting of customer’s basis in securities transactions (Act Div. B sec. 403).**—The provision makes conforming changes necessitated by the deletion of the defined term “open-end fund,” so that the provision refers to regulated investment companies rather than open-end funds.

The Act provides a definition of a dividend reinvestment plan (“DRP”), and also permits use of average cost basis for stock acquired after December 31, 2010 in connection with a DRP. The Act further provides that stock acquired before 2012 for which an average basis method is permissible is treated as a separate account from any such stock acquired after 2011, and provides an election for a regulated investment company to treat as a single account all stock held by a customer without regard to the date of acquisition of the stock. For stock for which an average basis method is permissible, the Act’s basis reporting requirements apply to stock acquired after December 31, 2011. The provision conforms the effective date for the availability of an average basis method for DRP stock to the effective date for the basis reporting requirement for stock for which an average basis method is permissible by making the former rule applicable to DRP stock acquired after December 31, 2011 (rather than December 31, 2010). The provision makes a conforming change to the effective date provision applicable to required basis reporting related to DRP stock. Under this change, unless a broker elects otherwise, basis reporting for DRP stock remains mandatory, as under the Act, only for stock acquired on or after January 1, 2012.

The provision also clarifies that if an election is made to treat as a single account all stock acquired in connection with a DRP, the average basis method is permissible with respect to all such stock without regard to the date of acquisition of the stock.

*Division C, Tax Extenders and Alternative Minimum Tax Relief Act of 2008*

**Qualified investment entities (Act Div. C sec. 208).**—The Act generally extends the inclusion of a RIC within the definition of a “qualified investment entity” under the FIRPTA rules of section 897 through December 31, 2009. The Act imposes withholding tax on certain RIC distributions to foreign shareholders; however, distributions may have been made after the provision had expired on December 31, 2007, but before the extension was enacted. The provision clarifies that no withholding is required for distributions that were made on or before the date of enactment (October 4, 2008). The provision also clarifies that a RIC is not liable to a foreign shareholder to whom a distribution was made before October 4, 2008, for amounts that were withheld from such a distribution and paid over to the Secretary.

**Extension of 15-year straight-line cost recovery for qualified leasehold improvements and qualified restaurant improvements; 15-year straight-line cost recovery for certain improvements to retail space (Act Div. C sec. 305).**—The Act expands the application of the 15-year MACRS recovery period to restaurant property, for property placed in service after December 31, 2008, and to a new category of retail improvement property, also for property placed in service after December 31, 2008. Both of these rules provide that bonus depreciation generally is not available for such property. The provision clarifies, however, that assets that qualify as both qualified leasehold improvement property and either qualified restaurant property or qualified retail improvement property qualify for bonus depreciation, consistent with the legislative intent with respect to assets that overlap in this manner.

*Amendments to the Heroes Earnings Assistance and Relief Tax Act of 2008 (Pub. L. No. 110–245)*

**Special period of limitation when uniformed services retired pay is reduced as result of award of disability compensation (Act sec. 106).**—The provision clarifies that the date of enactment, June 17, 2008, applies for purposes of the portion of the transition rule specifying what date should be substituted for the date of the determination.

**Disposition of unused health benefits in flexible spending accounts (Act sec. 114).**—The Act provides that a plan does not fail to be treated as a cafeteria plan or health FSA merely because the plan provides for qualified reservist distributions. The provision clarifies that a plan does not fail to be treated as an accident or health plan under Code section 105 merely because it provides for qualified reservist distributions.

*Amendments to the Economic Stimulus Act of 2008 (Pub. L. No. 110–185)*

**2008 recovery rebates for individuals (Act sec. 101).**—The provision clarifies that summary assessment procedures can apply with respect to the omission of any correct valid identification number that is required.

***Amendments to the Tax Technical Corrections Act of 2007***  
***(Pub. L. No. 110–172)***

**Act section 4(c).**—The provision reinstates a part of Code section 911, relating to the netting of disallowed deductions against excluded income that was inadvertently deleted by the Act.

***Amendments to the Tax Relief and Health Care Act of 2006***  
***(Pub. L. No. 109–432)***

**WOTC and Indian employment credit (Act sec. 105).**—Code section 45A(b)(1)(B) coordinates the Indian employment credit with WOTC. It provides that wages are not taken into account during the one-year period beginning on the date the individual begins work for the employer if wages are taken into account under WOTC. In 2006, a second year was added to WOTC for long-term family assistance recipients (section 51(e)). The provision clarifies that the two-year period is taken into account for purposes of section 45A(b)(1)(B) if any portion of wages are taken into account under subsection (e)(1)(A) of section 51.

***Amendments to the Safe, Accountable, Flexible, Efficient Transportation Equity Act of 2005: A Legacy for Users***  
***(SAFETY-LU) (Pub. L. No. 109–59)***

**Transfer to Highway Trust Fund of amounts equivalent to certain taxes and penalties (Act sec. 11161).**—The taxes on aviation fuel and aviation gasoline, imposed on removal from a terminal directly into the fuel tank of an aircraft, are credited to the Airport and Airways Trust Fund (sec. 9502(b)(1)(D)). The provision makes a technical amendment to section 9503(b)(1)(D) to clarify that the Highway Trust Fund is not credited with these same amounts.

***Amendments to the American Jobs Creation Act of 2004 (Pub. L. No. 108–357)***

**ETI and Code section 199 circularity (Act sec. 101).**—The provision incorporates an ordering rule for purposes of section 114 of the Code that requires the computation of the section 114 extraterritorial income (“ETI”) exclusion without regard to the section 199 deduction. Under this ordering rule, a taxpayer must first compute the amount of the section 114 exclusion, determined without regard to the section 199 deduction, before the taxpayer computes its section 199 deduction. As under present law, any amount excluded from gross income pursuant to section 114 continues to be taken into account in determining qualified production activities income (“QPAI”). The provision is consistent with technical corrections previously made to provide ordering rules to avoid circular calculations resulting from the interaction between the computations under section 199 and sections 163(j), 170, and 613A.

**Section 199 W–2 wages (Act sec. 102).**—Section 199(b)(2)(A) provides that the amounts included as W–2 wages are only those amounts paid during the calendar year ending during the taxable year of a taxpayer. In some instances, this results in taxable years in which no W–2 wages are included (*e.g.*, short years that do not include December 31). Consequently, in such instances, the taxpayer may be precluded from claiming a section 199 deduction due



to the W-2 wage limitation. Although section 199(b)(3) provides the Secretary with authority to address cases in which there may be a short taxable year as a result of a taxpayer's acquisition or disposition of a trade or business (or a major portion of a separate unit of a trade or business), it does not provide explicit authority to address other circumstances that result in a short taxable year (*e.g.*, change in accounting period).

The provision provides the Secretary the authority to issue guidance for short taxable years (outside of the context of an acquisition or disposition) permitting the allocation of W-2 wages to a short taxable year that does not include the end of a calendar year. For example, the Secretary may issue guidance that permits a taxpayer to allocate a portion of the annual W-2 wages to a short taxable year that does not include the end of the calendar year and the full amount of such W-2 wages to the subsequent 12-month taxable year that includes such calendar year end.

#### ***Clerical corrections***

The Act makes clerical and typographical corrections.

#### **B. Deadwood Provisions (sec. 221 of the Act)**

A number of provisions in the Internal Revenue Code are not used in computing current taxes and thus are obsolete. These provisions are referred to as "deadwood." The Act repeals 16 sections of the Code and repeals or amends portions of more than 100 other sections of the Code to remove deadwood. The Act does not change substantive law.

The amendments relating to deadwood made by the Act are effective on the date of enactment (December 19, 2014). The Act includes savings provisions to mitigate the effects of repealing the deadwood items in the event those items have any remaining applicability to past transactions. For example, if a transfer of property took place before the date of enactment, the basis of the property is not changed by reason of any provision of the Act that amends a Code section relating to the determination of basis.

### **TITLE III—JOINT COMMITTEE ON TAXATION**

#### **A. Increased Refund and Credit Threshold for Joint Committee on Taxation Review of C Corporation Return (sec. 301 of the Act and sec. 6405 of the Code)**

##### ***Present Law***

No refund or credit in excess of a specified dollar threshold of any income tax, estate or gift tax, or certain other specified taxes, may be made until 30 days after the date a report on the refund is provided to the Joint Committee on Taxation.<sup>587</sup> The specified dollar threshold for review is \$2,000,000. A report is also required in the case of certain tentative refunds. Additionally, the staff of the Joint Committee on Taxation conducts post-audit reviews of large deficiency cases and other select issues.

---

<sup>587</sup> Sec. 6405.

### ***Explanation of Provision***

The provision increases the threshold above which refunds must be submitted to the Joint Committee on Taxation for review from \$2,000,000 to \$5,000,000 in the case of a C corporation.<sup>588</sup> The staff of the Joint Committee on Taxation continues to be authorized to conduct a program of expanded post-audit reviews of large deficiency cases and other select issues.

### ***Effective Date***

The provision is effective on the date of enactment (December 19, 2014), except that the higher threshold does not apply to a refund or credit with respect to which a report was made before the date of enactment.

## **DIVISION B—STEPHEN BECK, JR., ACHIEVING A BETTER LIFE EXPERIENCE ACT OF 2014 OR THE STEPHEN BECK, JR., ABLE OF ACT 2014**

### **TITLE I—QUALIFIED ABLE PROGRAMS**

#### **A. Qualified Able Programs (secs. 101–105 of the Act and section 529 and new section 529A of the Code)**

##### ***Present Law***

##### ***In general***

Although present law does not contain tax-advantaged savings vehicles specifically targeted to persons with disabilities, present law does contain other tax-advantaged savings vehicles, as well as a trust and estates provision intended for those with disabilities. Below is a description of one such savings vehicle and that trust and estates provision.

##### ***Section 529 qualified tuition programs***

A qualified tuition program is a program established and maintained by a State or agency or instrumentality thereof, or by one or more eligible educational institutions, which satisfies certain requirements and under which a person may purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary (a “prepaid tuition program”). In the case of a program established and maintained by a State or agency or instrumentality thereof, a qualified tuition program also includes a program under which a person may make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account, provided it satisfies certain specified requirements (a “savings account program”). Under both types of qualified tuition programs, a contributor establishes an account for the benefit of a particular designated beneficiary to provide for that beneficiary’s higher education expenses. Section 529 provides specified income

<sup>588</sup> A C corporation is a corporation which is not an S corporation for the taxable year (sec. 1361(a)(2)).

tax and transfer tax rules for the treatment of accounts and contracts established under qualified tuition programs.<sup>589</sup>

For this purpose, qualified higher education expenses means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution, and expenses for special needs services in the case of a special needs beneficiary that are incurred in connection with such enrollment or attendance. Qualified higher education expenses generally also include room and board for students who are enrolled at least half-time.

Contributions to a qualified tuition program must be made in cash. Section 529 does not impose a specific dollar limit on the amount of contributions, account balances, or prepaid tuition benefits relating to a qualified tuition account; however, the program is required to have adequate safeguards to prevent contributions in excess of amounts necessary to provide for the beneficiary's qualified higher education expenses. Contributions generally are treated as a completed gift eligible for the gift tax annual exclusion. Contributions are not tax deductible for Federal income tax purposes, although they may be deductible for State income tax purposes. Amounts in the account accumulate on a tax-deferred basis (i.e., income on accounts under the program is not subject to current income tax).

A qualified tuition program may not permit any contributor to, or designated beneficiary under, the program to direct (directly or indirectly) the investment of any contributions (or earnings thereon) and must provide separate accounting for each designated beneficiary.<sup>590</sup> A qualified tuition program may not allow any interest in an account or contract (or any portion thereof) to be used as security for a loan.

Distributions from a qualified tuition program are excludable from the distributee's gross income to the extent that the total distribution does not exceed the qualified higher education expenses incurred for the beneficiary. If a distribution from a qualified tuition program exceeds the qualified higher education expenses incurred for the beneficiary, the portion of the excess that is treated as earnings generally is subject to income tax and an additional 10-percent tax. Amounts in a qualified tuition program may be rolled over without income tax liability to another qualified tuition program for the same beneficiary or for a member of the family of that beneficiary.

In general, prepaid tuition contracts and tuition savings accounts established under a qualified tuition program involve prepayments or contributions made by one or more individuals for the benefit of a designated beneficiary. Decisions with respect to the contract or account are made by an individual who is not the designated beneficiary. Qualified tuition accounts or contracts generally require the designation of a person (generally referred to as an "account

<sup>589</sup> For purposes of this description, the term "account" is used interchangeably to refer to a prepaid tuition benefit contract or a tuition savings account established pursuant to a qualified tuition program.

<sup>590</sup> However, *see* IRS Notice 2001-55, 2001-2 C.B. 299, which provides that a program does not violate the investment restriction under section 529(b)(4) if it permits a change in the investment strategy selected for a section 529 account once per calendar year, and upon a change in the designated beneficiary of the account.

owner”)<sup>591</sup> whom the program administrator (oftentimes a third party administrator retained by the State or by the educational institution that established the program) may look to for decisions, recordkeeping, and reporting with respect to the account established for a designated beneficiary. The person or persons who make the contributions to the account need not be the same person who is regarded as the account owner for purposes of administering the account. Under many qualified tuition programs, the account owner generally has control over the account or contract, including the ability to change designated beneficiaries and to withdraw funds at any time and for any purpose. Thus, in practice, qualified tuition accounts or contracts generally involve a contributor, a designated beneficiary, an account owner (who oftentimes is not the contributor or the designated beneficiary), and an administrator of the account or contract.

***Treatment of savings accounts under Federal programs***<sup>592</sup>

Means-tested programs typically include income and resources limits designed to properly target benefits to individuals with limited income and other financial resources on which to depend for support. Income is the money an individual receives in a month from wages and other sources while resources are savings and other items of significant value that individuals may own, such as a home or vehicle. Income and resources limits vary from program to program and sometimes from State to State for State-administered programs such as Medicaid. The Supplemental Security Income (“SSI”) program is Federally-administered and has a \$2,000 resource limit for individuals. In most States, SSI receipt confers Medicaid eligibility. When SSI recipients have income and resources over the limit, their SSI benefits are suspended but they remain eligible for Medicaid.

***Use of a trust to provide for the needs of a disabled person***

*In general*

A specially designed trust, sometimes referred to as special needs trusts or supplemental needs trust, may be used to provide financial assistance to a disabled person (the trust beneficiary) without disqualifying the beneficiary for certain government benefits, such as Medicaid. The trust may be established using the disabled person’s own funds (a self-settled trust) or the funds of a third party who does not have a legal obligation to support the trust beneficiary (a third-party trust).

The assets of a carefully drafted third-party trust generally are not counted when determining the beneficiary’s eligibility for Medicaid. Assets held in a self-settled trust, however, generally are counted when determining Medicaid eligibility unless, for example, the trust is described in section 1917(d)(4)(A) of the Social Security Act. That section describes a trust: (1) containing the assets of an individual who is disabled (within the meaning of section

<sup>591</sup>Section 529 refers to contributors and designated beneficiaries, but does not define or otherwise refer to the term “account owner,” which is a commonly used term among qualified tuition programs.

<sup>592</sup>The description in this paragraph was prepared by the staff of the Ways and Means Human Resources Subcommittee.

1614(a)(3) of the Social Security Act); (2) which is established for the benefit of the individual by a parent, grandparent, legal guardian, or a court; and (3) pursuant to the terms of which the State will be reimbursed upon the individual's death for the total amount of medical assistance paid on behalf of the individual under the State's Medicaid plan, up to the amount of the assets remaining in the trust upon the death of the individual.

*Income tax deduction for qualified disability trusts*

Under present law, a qualified disability trust is allowed a deduction for a personal exemption equal to that of an unmarried individual (for 2014, \$3,900 subject to phaseout if adjusted gross income exceeds \$254,200)).<sup>593</sup>

In addition, amounts distributed to a child who is a beneficiary of a qualified disability trust are treated as earned income for purposes of the "kiddie" tax and thus are not taxed at parents' tax rates.<sup>594</sup>

For these purposes a qualified disability trust means a disability trust described in section 1917(c)(2)(B)(iv) of the Social Security Act<sup>595</sup> all the beneficiaries of which are determined to be disabled (within the meaning of section 1614(a)(3) of that Act).

***Reasons for Change***

The Congress recognized the special financial burdens borne by families raising children with disabilities and the fact that increased financial needs generally continue throughout the child's lifetime. Present law provided for various types of tax-advantaged savings arrangements; however, none of these arrangements adequately served the goal of promoting saving for these financial needs. The creation of qualified ABLE programs with tax-favored treatment of ABLE accounts for eligible beneficiaries will assist families and disabled individuals in meeting their financial needs.

***Explanation of Provision***

***In general***

The provision provides rules for a new type of tax-favored savings program, qualified ABLE programs. A qualified ABLE program is a program established and maintained by a State or agency or instrumentality thereof. A qualified ABLE program must meet the following conditions: (1) under the provisions of the program, contributions may be made to an account (an "ABLE account"), established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account; (2) the program must limit a designated beneficiary to one ABLE account; (3) the program must allow for the establishment of ABLE accounts only for a designated beneficiary who is either a resident of the State maintaining such ABLE program or a resident of a State that

<sup>593</sup> Sec. 642(b)(2)(C). The exemption amount of a trust generally is either \$100 or \$300 (if required to distribute all its income currently).

<sup>594</sup> Sec. 1(g)(4)(C).

<sup>595</sup> Section 1917(c)(2)(B)(iv) of the Social Security Act describes trusts, including disability trusts described in section 1917(d)(4) of that Act, established solely for the benefit of an individual under 65 years of age who is disabled (within the meaning of section 1614(a)(3) of that Act).

has not established an ABLE program (a “contracting State”) which has entered into a contract with such State to provide the contracting State’s residents with access to the State’s ABLE program; and (4) the program must meet certain other requirements discussed below. A qualified ABLE program is generally exempt from income tax, but is otherwise subject to the taxes imposed on the unrelated business income of tax-exempt organizations.

A designated beneficiary of an ABLE account is the owner of the ABLE account. A designated beneficiary must be an eligible individual (defined below) who established the ABLE account and who is designated at the commencement of participation in the qualified ABLE program as the beneficiary of amounts paid (or to be paid) into and from the program.

Contributions to an ABLE account must be made in cash and are not deductible for Federal income tax purposes. Under the provision, except in the case of a rollover contribution from another ABLE account, an ABLE account must provide that it may not receive aggregate contributions during a taxable year in excess of the amount under section 2503(b) of the Code (the annual gift tax exemption). For 2014, this is \$14,000.<sup>596</sup> Additionally, a qualified ABLE program must provide adequate safeguards to ensure that ABLE account contributions do not exceed the limit imposed on accounts under the qualified tuition program<sup>597</sup> of the State maintaining the qualified ABLE program. Amounts in the account accumulate on a tax-deferred basis (i.e., income on accounts under the program is not subject to current income tax).

A qualified ABLE program may permit a designated beneficiary to direct (directly or indirectly) the investment of any contributions (or earnings thereon) no more than two times in any calendar year and must provide separate accounting for each designated beneficiary. A qualified ABLE program may not allow any interest in the program (or any portion thereof) to be used as security for a loan.

Distributions from an ABLE account are generally includible in the distributee’s income to the extent consisting of earnings on the account.<sup>598</sup> Distributions from an ABLE account are excludable from income to the extent that the total distribution does not exceed the qualified disability expenses of the designated beneficiary during the taxable year. If a distribution from an ABLE account exceeds the qualified disability expenses of the designated beneficiary, a pro rata portion of the distribution is excludable from income. The portion of any distribution that is includible in income is subject to an additional 10-percent tax unless the distribution is made after the death of the beneficiary. Amounts in an ABLE account may be rolled over without income tax liability to another

<sup>596</sup> This amount is indexed for inflation. In the case that contributions to an ABLE account exceed the annual limit, an excise tax in the amount of six percent of the excess contribution to such account is imposed on the designated beneficiary. Such tax does not apply in the event that the trustee of such account makes a corrective distribution of such excess amounts by the due date (including extensions) of the individual’s tax return for the taxable year in which the contribution was made.

<sup>597</sup> As described in Present Law, rules for qualified tuition programs are contained in section 529.

<sup>598</sup> The rules of section 72 apply in determining the portion of a distribution that consists of earnings.

ABLE account for the same beneficiary<sup>599</sup> or another ABLE account for the designated beneficiary's brother, sister, stepbrother or stepsister who is also an eligible individual.

Under the provision, except in the case of an ABLE account established in a different ABLE program for purposes of transferring ABLE accounts,<sup>600</sup> no more than one ABLE account may be established by a designated beneficiary. Thus, once an ABLE account has been established by a designated beneficiary, no account subsequently established by such beneficiary shall be treated as an ABLE account. The provision provides the Secretary of the Treasury ("Secretary") with the authority to prescribe regulations to enforce the one ABLE account limitation.

Under the provision, a contribution to an ABLE account is treated as a completed gift of a present interest to the designated beneficiary of the account. Such contributions qualify for the per-donee annual gift tax exclusion (\$14,000 for 2014) and, to the extent of such exclusion, are exempt from the generation skipping transfer ("GST") tax. A distribution from an ABLE account generally is not subject to gift tax or GST tax.

### ***Eligible individuals***

As described above, under the provision a qualified ABLE program may provide for the establishment of ABLE accounts only if those accounts are established and owned by an eligible individual, such owner referred to as a designated beneficiary. For these purposes, an eligible individual is an individual either (1) for whom a disability certification has been filed with the Secretary for the taxable year, or (2) who is entitled to Social Security Disability Insurance benefits or SSI benefits<sup>601</sup> based on blindness or disability, and such blindness or disability occurred before the individual attained age 26.

A disability certification means a certification to the satisfaction of the Secretary, made by the eligible individual or the parent or guardian of the eligible individual, that the individual has a medically determinable physical or mental impairment, which results in marked and severe functional limitations, and which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months, or is blind (within the meaning of section 1614(a)(2) of the Social Security Act). Such blindness or disability must have occurred before the date the individual attained age 26. Such certification must include a copy of the diagnosis of the individual's impairment and be signed by a licensed physician.<sup>602</sup>

As discussed further below, the provision provides that, not later than six months after the date of enactment, the Secretary shall develop regulations or other guidance on certain aspects of the proposal. Among these aspects are regulations, to be developed in consultation with the Commissioner of Social Security, relating to disability certifications and determinations of disability including

<sup>599</sup> For instance, if a designated beneficiary were to relocate to a different State.

<sup>600</sup> In which case the contributor ABLE account must be closed 60 days after the transfer to the new ABLE account is made.

<sup>601</sup> These are benefits, respectively, under Title II or Title XVI of the Social Security Act.

<sup>602</sup> No inference may be drawn from a disability certification for purposes of eligibility for Social Security, SSI or Medicaid benefits.

those conditions which are deemed to have occurred prior to age 26. It is intended that individuals with those conditions shall be required to present only limited (or no) evidence demonstrating that the condition occurred prior to age 26. This list of conditions should operate in a manner similar to the SSA's Compassionate Allowances, which targets the most obviously disabled individuals for allowances based on objective medical information that can be obtained quickly. Compassionate Allowances are selected using information received at public outreach hearings, comments received from the Social Security and Disability Determination Services communities, the counsel of medical and scientific experts, and research conducted by the National Institutes of Health.

### ***Qualified disability expenses***

As described above, the earnings on distributions from an ABLE account are excluded from income only to the extent total distributions do not exceed the qualified disability expenses of the designated beneficiary. For this purpose, qualified disability expenses are any expenses related to the eligible individual's blindness or disability which are made for the benefit of the designated beneficiary. Such expenses include the following expenses: education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, funeral and burial expenses, and other expenses, which are approved by the Secretary under regulations and consistent with the purposes of the provision.

### ***Reporting requirements***

Under the provision, each officer or employee having control of the qualified ABLE program (or their designee) is required to make reports to the Secretary and to the designated beneficiaries of ABLE accounts. Such reports must provide information with respect to contributions, distributions, the return of excess contributions, and other matters as required by the Secretary.

The provision also requires that a qualified ABLE program submit a notice to the Secretary upon the establishment of the ABLE account. Such notice shall contain the name and State of residence of the beneficiary, and other such information as the Secretary may require.

These reports and notices must be filed at such time and in such manner as required by the Secretary. A penalty of \$50 may apply with respect to any failure to provide a required report or notice.

For purposes of the rules relating to eligibility for SSI (discussed below), officers and employees having control of a qualified ABLE program must submit statements on account balances and distributions from all ABLE accounts to the Commissioner of the Social Security Administration. The statements must be submitted electronically on at least a monthly basis in the manner specified by the Commissioner of the Social Security Administration.

In addition, for research purposes, the Secretary shall make available to the public reports containing aggregate information, by diagnosis and other relevant characteristics, on contributions and



distributions to and from qualified ABLE programs. However, an item of information may not be made publicly available if it can be associated with, or otherwise identify, directly or indirectly, a particular individual.

### ***Transfer to State***

Under the provision, in the event that the designated beneficiary dies, subject to any outstanding payments due for qualified disability expenses incurred by the designated beneficiary, all amounts remaining in the deceased designated beneficiary's ABLE account not in excess of the amount equal to the total medical assistance paid such individual under any State Medicaid plan established under title XIX of the Social Security Act shall be distributed to such State upon filing of a claim for payment by such State. Such repaid amounts shall be net of any premiums paid from the account or by or on behalf of the beneficiary to the State's Medicaid Buy-In program.

### ***Regulations***

The Secretary is directed to issue regulations or other guidance as the Secretary determines is necessary or appropriate to carry out the purposes of the qualified ABLE program rules, including regulations (1) to enforce the one ABLE account per eligible individual limit; (2) providing for the information required to be presented to open an ABLE account; (3) to generally define disability expenses; (4) relating to disability certifications and determinations of disability, to be developed in consultation with the Commissioner of Social Security, as discussed above; (5) to prevent fraud and abuse with respect to amounts claimed as qualified disability expenses; (6) under the estate tax, gift tax, and generation-skipping transfer tax provisions of the Code; and (7) to allow for transfers from one ABLE account to another ABLE account. The Secretary is directed to issue such regulations or other guidance no later than six months after the date of enactment.

### ***Treatment of ABLE accounts under Federal programs***

Under the provision, any amounts in an ABLE account, and any distribution for qualified disability expenses, shall be disregarded for purposes of determining eligibility to receive, or the amount of, any assistance or benefit authorized by any Federal means-tested program. However, in the case of the SSI program, a distribution for housing expenses is not disregarded, nor are amounts in an ABLE account in excess of \$100,000. In the case that an individual's ABLE account balance exceeds \$100,000, such individual's SSI benefits shall not be terminated, but instead shall be suspended until such time as the individual's resources fall below \$100,000. However, such suspension shall not apply for purposes of Medicaid eligibility.

### ***Treatment of ABLE accounts in bankruptcy***

Property of a bankruptcy estate may not include certain amounts contributed to an ABLE account, if the designated beneficiary of such account was a child, stepchild, grandchild or stepgrandchild of the debtor during the taxable year in which funds were placed

in the account. Such funds shall be excluded from the bankruptcy estate only to the extent that they were contributed to an ABLE account at least 365 days prior to the filing of the title 11 petition, are not pledged or promised to any entity in connection with any extension of credit, and are not excess contributions as defined in new section 4973(h). In the case of funds contributed to an ABLE account that are contributed not earlier than 720 days (and not later than 365 days) prior to the filing of the petition, only up to \$6,225 may be excluded.

***Investment direction for qualified tuition programs***

The provision includes a modification of the present-law restriction on investment direction for qualified tuition programs. The provision permits a contributor to, or designated beneficiary of, a qualified tuition program, to direct the investment of any contributions to the program (or any earnings thereon), directly or indirectly, no more than two times in any calendar year. This rule is consistent with the rule provided for designated beneficiaries under new Code section 529A.

***Effective Date***

The amendments made by the provision relating to the establishment of ABLE programs are effective for taxable years beginning after December 31, 2014. The directive that the Secretary issue regulations within six months and the disregard of ABLE accounts and distributions from such accounts in the case of certain means-tested Federal programs are effective on the date of enactment (December 19, 2014).

**TITLE II—OFFSETS <sup>603</sup>**

**A. Modification Relating to Inland Waterways Trust Fund Financing Rate (sec. 205 of the Act and sec. 4042 of the Code)**

***Present Law***

The Code imposes a tax of 20 cents per gallon on fuel used in a vessel in commercial waterway transportation to fund the Inland Waterways Trust Fund. Commercial waterway transportation means any use of a vessel on any inland or intracoastal waterway of the United States in the business of transporting property for compensation or hire, or in transporting property in the business of the owner, lessee, or operator of the vessel (other than fish or other aquatic animal life caught on the voyage).

The Code provides several exemptions from the tax. The tax does not apply to fuel for vessels primarily used for passenger transportation. Nor does it apply to fuel used in deep-draft ocean-going vessels. Additional exemptions are provided for fuels used by State and local governments in transporting property in governmental business and for fuels used by tugs moving LASH (lighter-aboard-

<sup>603</sup>The offsets described herein are revenue provisions. Provisions included in the Act that reduce Federal spending (sections 201–205 of the Act) are not discussed.

ships) and seabee oceangoing barges released by their oceangoing carriers solely to pick up or deliver international cargoes.

The Army Corps of Engineers is responsible for the construction, operation and maintenance of inland waterway infrastructure. Present law allows up to 50 percent of the cost of construction projects to be funded by the Inland Waterway Trust Fund, the remainder to be funded from general revenues.

### ***Explanation of Provision***

The provision changes the rate of tax on fuel used in a vessel in commercial waterway transportation from 20 cents per gallon to 29 cents per gallon.

### ***Effective Date***

The provision is effective for fuel used after March 31, 2015.

### **B. Certified Professional Employer Organizations (sec. 206 of the Act and new secs. 3511, 6652(n), and 7705 of the Code)**

#### ***Present Law***

#### ***Background on professional employer organizations***

“Professional employer organization” is a term used for a firm that provides employees to perform services in the businesses of the professional employer organization’s customers, often small and medium-sized businesses.<sup>604</sup> In many cases, before the professional employer organization arrangement is entered into, the employees already work in the customer’s business as employees of the customer. The terms of a professional employer organization arrangement typically provide that the professional employer organization is the employer of the employees and is responsible for paying the employees and for the related employment tax compliance. The customer typically pays the professional employer organization a fee based on payroll costs plus an additional amount.<sup>605</sup>

In some cases, the employees provided to work in the customer’s business are legally the employees of the customer, and the customer is legally responsible for employment tax compliance. Nonetheless, customers generally rely on the professional employer organization for employment tax compliance (without designating the professional employer organization as a reporting agent, as discussed below) and treat the employees as employees of the professional employer organization.

#### ***Employment taxes***

Employment taxes generally consist of the taxes under the Federal Insurance Contributions Act (“FICA”), the taxes under the Railroad Retirement Tax Act (“RRTA”), the tax under the Federal Unemployment Tax Act (“FUTA”), and income taxes required to be

<sup>604</sup> “Professional employer organization” (or “PEO”) is not a legal term with a specific definition. The term “employee leasing company” is also sometimes used and is also not a legal term with a specific definition. When used, these terms can refer to any of a variety of arrangements.

<sup>605</sup> A professional employer organization may also provide employees with employee benefit coverage, such as under a retirement plan or a health plan, even if the customer does not maintain such a plan. In that case, the fee paid by the customer also covers employee benefit costs.

withheld by employers from wages paid to employees (“income tax withholding”).<sup>606</sup>

FICA tax consists of two parts: (1) old age, survivor, and disability insurance (“OASDI”), which correlates to the Social Security program that provides monthly benefits after retirement, disability, or death; and (2) Medicare hospital insurance (“HI”). The OASDI tax rate is 6.2 percent on both the employee and employer (for a total rate of 12.4 percent). The OASDI tax rate applies to remuneration up to the OASDI wage base for the calendar year (\$117,000 for 2014). The HI tax rate is 1.45 percent on both the employee and the employer (for a total rate of 2.9 percent). Unlike the OASDI tax, the HI tax is not limited by a wage base; all remuneration that otherwise meets the definition of wages for FICA purposes is subject to HI tax.<sup>607</sup>

RRTA taxes consist of tier 1 taxes and tier 2 taxes. Tier 1 taxes parallel the OASDI and HI taxes applicable to employers and employees. Tier 2 taxes consist of employer and employee taxes on railroad compensation up to the tier 2 wage base for the calendar year (\$87,000 for 2014).

Under FUTA, employers must pay a tax of six percent of wages up to the FUTA wage base of \$7,000. An employer may take a credit against its FUTA tax liability for its contributions to a State unemployment fund and, in certain cases, an additional credit for contributions that would have been required if the employer had been subject to a higher contribution rate under State law. For purposes of the credit, the term “contributions” means payments required by State law to be made by an employer into an unemployment fund, to the extent the payments are made by the employer without being deducted or deductible from employees’ remuneration.

Employers are required to withhold income taxes from wages paid to employees. Withholding rates vary depending on the amount of wages paid, the length of the payroll period, and the number of withholding allowances claimed by the employee.

Wages paid to employees, and FICA, RRTA, and income taxes withheld from the wages, are required to be reported on employment tax returns, generally on a quarterly basis, and on Form W-2.<sup>608</sup> Employment taxes are required to be deposited (that is, paid to the IRS) within a certain period after liability for the taxes arises (that is, after wages are paid).<sup>609</sup> The period within which employment taxes must be deposited depends on the amount of liability for a preceding 12 month period.

Employment taxes generally apply to all remuneration paid by an employer to an employee. In addition, various exclusions apply to certain types of remuneration or certain types of services, which may depend on the type of employer for whom an employee performs services.<sup>610</sup> For example, remuneration (subject to a dollar

<sup>606</sup> Secs. 3101–3128 (FICA), 3201–3241 (RRTA), 3301–3311 (FUTA), and 3401–3404 (income tax withholding). Sections 3501–3510 provide additional rules.

<sup>607</sup> Beginning 2013, the employee portion of the HI tax under FICA (not the employer portion) is increased by an additional tax of 0.9 percent on wages received in excess of a threshold amount. The threshold amount is \$250,000 in the case of a joint return, \$125,000 in the case of a married individual filing a separate return, and \$200,000 in any other case.

<sup>608</sup> Secs. 6011 and 6051.

<sup>609</sup> Sec. 6656.

<sup>610</sup> See, for example, secs. 3121(a) and (b), 3231(e), 3306(b) and (c), and 3401(a).

limit) paid to an employee by a tax-exempt organization is excluded from wages for FICA purposes, and services performed in the employ of certain tax-exempt organizations are excluded from employment for FUTA purposes.<sup>611</sup> In addition, various definitions and special rules apply to certain types of employers.<sup>612</sup>

Similarly, as indicated above, remuneration with respect to employment with a particular employer for a year is excepted from OASDI, RRTA tier 1 or tier 2, or FUTA taxes to the extent it exceeds the applicable OASDI, RRTA tier 1 or tier 2, or FUTA wage base.<sup>613</sup> In contrast, if an employee works for multiple employers during a year, a separate wage base generally applies in determining each employer's tax liability with respect to remuneration for employment with each employer.<sup>614</sup> However, a single wage base applies in certain cases in which an employer (a "successor" employer) takes over the business of another employer (the "predecessor" employer) and employs the employees of the predecessor employer.

### ***Responsibility for employment tax compliance***

Employment tax responsibility generally rests with the person who is the employer of an employee under a common-law test that has been incorporated into Treasury regulations.<sup>615</sup> Under the regulations, an employer-employee relationship generally exists if the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer, not only as to what is to be done, but also as to how it is to be done. It is not necessary that the employer actually control the manner in which the services are performed, rather it is sufficient that the employer have a right to control. Whether the requisite control exists is determined on the basis of all the relevant facts and circumstances. The test of whether an employer-employee relationship exists often arises in determining whether a worker is an employee or an independent contractor. However, the same test applies in determining whether a worker is an employee of one person or another.

<sup>611</sup> Secs. 3121(a)(16) and 3306(c)(8).

<sup>612</sup> See, for example, secs. 3121, 3122, 3125, 3126, 3127, 3231, 3306, 3308, 3309, 3401(a), 3404, 3506, and 3510.

<sup>613</sup> An employee is subject to OASDI or RRTA tax only with respect to remuneration up to the applicable wage base for a year, regardless of whether the employee works for only one employer or for more than one employer during the year. If, as a result of working for more than one employer, OASDI or RRTA tax is withheld with respect to remuneration above the applicable wage base, the employee is allowed a credit under section 31(b).

<sup>614</sup> A single wage base applies with respect to remuneration for employment with a particular employer for a year, regardless of whether the remuneration for that employment is paid solely by the employer or is paid in part (or instead) by another person who is not an employer of the employee. In a case in which (1) an employee works for an employer that, during a year, enters into an arrangement with a professional employer organization as a customer of the professional employer organization and (2) the employee continues to perform services for the customer pursuant to the arrangement, whether a single wage base applies with respect to remuneration already paid for the year by the customer and remuneration paid by the professional employer organization depends on whether the professional employer organization is an employer of the employee. See IRS Chief Counsel Advice 200017041, March 3, 2000, for a discussion of this issue.

<sup>615</sup> Treas. Reg. secs. 31.3121(d)-1(c)(1), 31.3306(i)-1(a), and 31.3401(c)-1. A similar concept applies for RRTA purposes under Treas. Reg. sec. 31.3231(b)-1(a)(1)(i).

In some cases, a person other than the common-law employer (a “third party”) may be liable for employment taxes. For example, if wages are paid to an employee by a third party and the third party, rather than the employer, has control of the payment of the wages, the third party is the statutory employer responsible for complying with applicable employment tax requirements.<sup>616</sup> In addition, an employer may designate an agent to be responsible for FICA tax and income tax withholding compliance,<sup>617</sup> including filing employment tax returns and issuing Forms W-2 to employees.<sup>618</sup> In that case, the agent and the employer are jointly and severally liable for compliance.<sup>619</sup>

### ***Income tax credits based on wages for employment tax purposes***

The Code provides various income tax credits to employers under which the amount of the credit is determined by reference to the amount of wages for employment tax purposes. For example, the amount of an employer’s work opportunity credit is based on a portion of FUTA wages paid by the employer to employees who are members of certain targeted groups.<sup>620</sup> In addition, the credit for employer FICA tax paid on tips is based on the employer’s share of FICA tax paid by the employer with respect to certain tips treated as wages for FICA purposes.<sup>621</sup>

### ***Reporting by large food and beverage establishments***

Certain reporting requirements relating to tips apply to large food or beverage establishments.<sup>622</sup> In the case of such an establishment, an employer is generally required to report the following information to the IRS each calendar year: (1) the gross receipts of the establishment from the provision of food and beverages, (2) the aggregate amount of charge receipts, (3) the aggregate amount of charged tips on the charge receipts, (4) the sum of the aggregate amount of tips reported to the employer by employees and certain amounts required to be reported by the employer on employees’

<sup>616</sup> Sec. 3401(d)(1) (for purposes of income tax withholding, if the employer does not have control of the payment of wages, the person having control of the payment of such wages is treated as the employer); *Otte v. United States*, 419 U.S. 43 (1974) (the person who has the control of the payment of wages is treated as the employer for purposes of withholding the employee’s share of FICA from wages); *In re Armadillo Corporation*, 561 F.2d 1382 (10th Cir. 1977), and *In re The Laub Baking Company v. United States*, 642 F.2d 196 (6th Cir. 1981) (the person who has control of the payment of wages is the employer for purposes of the employer’s share of FICA and FUTA). The mere fact that wages are paid by a person other than the employer does not necessarily mean that the payor has control of the payment of the wages. Rather, control depends on the facts and circumstances. See, for example, *Consolidated Flooring Services v. United States*, 38 Fed. Cl. 450 (1997), and *Winstead v. United States*, 109 F. 2d 989 (4th Cir. 1997).

<sup>617</sup> The designated reporting agent rules generally do not apply for purposes of FUTA compliance.

<sup>618</sup> Sec. 3504. Treas. Reg. sec. 31.3504-1 provides rules for the explicit designation of an agent by application to the IRS. Form 2678 is used for this purpose. In addition, under Treas. Reg. sec. 31.3504-2, designation of an agent may result from the payment of wages or compensation by a payor to an individual performing services for a client of the payor pursuant to a service agreement meeting certain criteria. The rules for designating an agent for FICA and income tax withholding purposes is a departure from the general principle that a taxpayer has a nondelegable duty with respect to tax obligations. See *United States v. Boyle*, 469 U.S. 241 (1985).

<sup>619</sup> Designation of an agent under section 3504 differs from an employer’s use of a payroll service to handle payroll and employment tax filings on its behalf. In that case, the employer, not the payroll service, continues to be legally responsible for employment tax compliance.

<sup>620</sup> Sec. 51(c)(1).

<sup>621</sup> Sec. 45B(b)(1).

<sup>622</sup> Sec. 6053(c).

Forms W-2, and (5) with respect to each employee, the amount of tips allocated to the employee based on the receipts of the establishment. The employer must also provide employees with written statements showing certain information each calendar year, including the amount of tips allocated to the employee for the year.

### ***Certain tax administration provisions***

#### *Taxpayer bonds*

In certain situations, the Code provides for a taxpayer to provide a bond to assure payment of a tax liability.<sup>623</sup>

#### *Confidentiality and public disclosure of tax information*

Returns (including information returns) and return information received by the IRS are generally subject to confidentiality protections and cannot be disclosed unless specifically authorized.<sup>624</sup> The prohibition on disclosure does not apply with respect to Code provisions that specifically require the public disclosure of certain information.<sup>625</sup>

#### *User fees*

User fees apply to requests to the IRS for ruling letters, opinion letters, determination letters, and similar requests.<sup>626</sup> The user fees that apply are determined by the IRS and are generally required to be determined after taking into account the average time and difficulty involved in a request.

### ***Explanation of Provision***

#### ***Treatment of certified professional employer organization as employer for employment tax purposes***

Under the provision, if certain requirements are met, for purposes of employment taxes and other obligations under the employment tax rules, a certified professional employer organization is treated as the employer of any work site employee performing services for any customer of the certified professional employer organization, but only with respect to remuneration remitted to the work site employee by the certified professional employer organization. In addition, no other person is treated as the employer for employment tax purposes with respect to remuneration remitted by the certified professional employer organization to a work site employee.

Under the provision, exceptions, exclusions, definitions, and other rules that are based on type of employer and that would apply if the certified professional employer organization were not treated as the employer under the provision continue to apply.

<sup>623</sup> See, for example, sections 6165 (furnishing of bond in connection with an extension of time to pay a tax or deficiency) and 6325(b) (release of a tax lien on furnishing of a bond). See sections 7101–7103 and Internal Revenue Manual Part 5.6.1, Collateral Agreements and Security Type Collateral (in particular, Part 5.6.1.2.1) and Part 5.6.2, Maintenance (in particular Part 5.6.2.6.1 and 5.6.2.7.1) for procedures relating to bonds provided by a taxpayer to assure payment of a tax liability.

<sup>624</sup> Sec. 6103.

<sup>625</sup> See, for example, section 6104, requiring the public disclosure of certain information relating to tax-exempt organizations and tax-favored retirement savings arrangements.

<sup>626</sup> Sec. 7528.

Thus, for example, if services performed in the employ of a customer that is a tax-exempt organization would be excluded from employment for FUTA purposes, the fact that a certified professional employer organization is treated as the employer for employment tax purposes does not affect the application of the exclusion.

The provision contains rules under which, on entering into a service contract with a customer with respect to a work site employee, a certified professional employer organization is treated as a successor employer and the customer is treated as the predecessor employer. Similarly, on termination of a service contract with respect to a worksite employee, the customer is treated as a successor employer and the certified professional employer organization is treated as a predecessor employer. Thus, remuneration paid by the customer and remuneration paid by the certified professional employer organization to a work site employee during a calendar year are both subject to a single OASDI, RRTA tier 1 or tier 2, or FUTA wage base.<sup>627</sup>

The provision does not apply in the case of a customer who is related to the certified professional employer organization.<sup>628</sup> In addition, an individual with net earnings from self-employment derived from a customer's trade or business (that is, a self-employed individual), including a customer who is a sole proprietor or a partner of a customer that is a partnership, is not a work site employee for employment tax purposes with respect to remuneration paid by a certified professional employer organization.

As discussed more fully below, a work site employee is an individual who performs services (1) for a customer pursuant to a contract between the customer and the certified professional employer organization that meets certain requirements and (2) at a work site that meets certain requirements. Thus, if the contract or work site fails to meet these requirements, the individual is not a work site employee. The provision applies also in the case of an individual (other than a self-employed individual) who is not a work site employee, but who performs services under a contract that meets the specified requirements. In this case, solely for purposes of a certified professional employer organization's liability for employment taxes and other obligations under the employment tax rules, a certified professional employer organization is treated as the employer of such an individual, but only with respect to remuneration remitted to the individual by the certified professional employer organization.<sup>629</sup> With respect to such an individual, exceptions, exclusions, definitions, and other rules that are based on the type of employer and that would apply if the certified professional employer organization were not treated as the employer under the provision continue to apply.

<sup>627</sup> Under this provision, a single wage base applies with respect to remuneration paid to a work site employee by the customer and the certified professional employer organization, regardless of whether the certified professional employer organization is an employer of the employee.

<sup>628</sup> Whether a customer and a certified professional employer organization are related is determined under the rules of section 267(b) (relating to transactions between related taxpayers) or 707(b) (relating to transactions between a partner and partnership). However, rules based on more than 50 percent ownership are applied by substituting 10 percent for 50 percent.

<sup>629</sup> In this case, the provision does not preclude another person from being treated as the employer, in addition to the certified professional employer organization, and potentially also bearing employment tax and related liability with respect to remuneration remitted by the certified professional employer organization.



A certified professional employer organization is eligible for the FUTA credit for contributions made to a State unemployment fund by the certified professional employer organization or a customer with respect to wages paid to a work site employee. An additional FUTA credit may be claimed by a certified professional employer organization if, under State law, a certified professional employer organization is permitted to collect and remit contributions with respect to a work site employee to the State unemployment fund.

Except to the extent necessary for purposes of the provision treating a certified professional employer organization as the employer for employment tax purposes, nothing in the provision is to be construed to affect the determination of who is an employee or employer for purposes of the Code.

***Certified professional employer organization***

A certified professional employer organization is a person (“applicant”) who applies to the Secretary of the Treasury (“Secretary”) to be treated as a certified professional employer organization for purposes of the provision and has been certified by the Secretary as meeting certain requirements. These requirements are met if the applicant—

- demonstrates that the applicant (and any owner, officer, and other persons as may be specified in regulations) meets requirements established by the Secretary, including requirements with respect to tax status, background, experience, business location, and annual financial audits,
- agrees to satisfy the bond and independent financial review requirements (described below) on an ongoing basis,
- agrees to satisfy any reporting obligations imposed by the Secretary,
- computes its taxable income using an accrual method of accounting unless the Secretary approves another method,
- agrees to verify on a periodic basis as prescribed by the Secretary that it continues to meet the requirements for certification, and
- agrees to notify the Secretary in writing within the time prescribed by the Secretary of any change that materially affects the continuing accuracy of any agreement or information that was previously made or provided.

As described above, the provision includes a nonexhaustive list of requirements that an applicant, as well as any owner, officer, or other person as may be specified in regulations, must demonstrate are met in order to be certified. To the extent considered appropriate by the Secretary, regulations could include requirements such as the following for certification:

- proven history of tax compliance in any applicable tax areas, such as income, employment and excise taxes,
- favorable credit and criminal background checks,
- adequate experience with respect to Federal and State employment tax and related requirements, handling of and accounting for funds on behalf of others, effective record-keeping systems, and retention of qualified personnel and legal advisors as needed,

- existence of an established business location within the United States at which significant operations regularly take place, and
- expected continuity of business existence, regardless of change in ownership.

Under the bond requirement, a certified professional employer organization must post a bond for the payment of employment taxes in a minimum amount and in a form acceptable to the Secretary. The minimum amount is determined for the period April 1 of any calendar year through March 31 of the following calendar year and is the greater of (1) five percent of the employment taxes for which the certified professional employer organization is liable under the provision during the preceding calendar year (but not to exceed \$1,000,000), or (2) \$50,000.

Under the independent financial review requirements, a certified professional employer organization must (1) as of the most recent audit date (that is, six months after the completion of the certified professional employer organization's fiscal year), have caused to be prepared and provided to the Secretary an opinion of an independent certified public accountant as to whether the certified professional employer organization's financial statements are presented fairly in accordance with generally accepted accounting principles, and (2) not later than the last day of the second month beginning after the end of each calendar quarter, provide the Secretary with an assertion regarding Federal employment tax payments and an examination level attestation on the assertion from an independent certified public accountant. The assertion must state that the certified professional employer organization has withheld and made deposits of all required FICA, RRTA, and withheld income taxes for the calendar quarter, and the attestation must state that the assertion is fairly stated in all material respects. If a certified professional employer organization fails to file the required assertion and attestation for any calendar quarter, the independent financial review requirements are treated as not satisfied for the period beginning on the due date for the attestation.

For purposes of the bond and independent financial review requirements, all professional employer organizations that are members of a controlled group of corporations or under common control are treated as a single organization.<sup>630</sup>

The Secretary may suspend or revoke the certification of a person's certified professional employer organization status if the Secretary determines that the person does not satisfy the agreements or other requirements for certification or fails to satisfy the applicable accounting, reporting, payment, or deposit requirements.

### ***Work site employee***

A work site employee is an individual who (1) performs services for a customer of a certified professional employer organization pursuant to a contract between the customer and the certified professional employer organization that meets certain requirements, described below (referred to herein as a "qualifying service con-

<sup>630</sup> Whether entities are members of a controlled group of corporations or under common control is determined under the rules of section 414(b) and (c).

tract”) and (2) performs services at a work site meeting certain requirements, described below.<sup>631</sup>

In order to be a qualifying service contract, the contract between the customer and the certified professional employer organization must be in writing and, with respect to an individual performing services for the customer, must provide that the certified professional employer organization will—

- assume responsibility for payment of wages to the individual, without regard to the receipt or adequacy of payment from the customer,
- assume responsibility for reporting, withholding, and paying any employment taxes with respect to the individual’s wages, without regard to the receipt or adequacy of payment from the customer,
- assume responsibility for any employee benefits that the contract may require the certified professional employer organization to provide, without regard to the receipt or adequacy of payment from the customer,
- assume responsibility for recruiting, hiring and firing workers in addition to the customer’s responsibility for recruiting, hiring and firing workers,
- maintain employee records relating to the individual, and
- agree to be treated as a certified professional employer organization for employment tax purposes with respect to such individual.

For purposes of whether an individual is a work site employee, the work site where the individual performs services meets the applicable requirements if at least 85 percent of the individuals performing services for the customer at the work site are subject to one or more qualifying service contracts with the certified professional employer organization.<sup>632</sup>

#### ***Income tax credits based on wages for employment tax purposes***

Under the provision, for purposes of various income tax credits under which the amount of the credit is determined by reference to the amount of employment tax wages or employment taxes (“specified” credits), (1) the credit with respect to a worksite employee performing services for a customer applies to the customer, not to the certified professional employer organization, (2) the customer, and not the certified professional employer organization, is to take into account wages and employment taxes paid by the certified professional employer organization with respect to the worksite employee and for which the certified professional employer organization receives payment from the customer, and (3) the certified professional employer organization is required to furnish the customer and the Secretary with any information necessary for the customer to claim the credit.<sup>633</sup>

<sup>631</sup> As discussed above, a self-employed individual is not a work site employee.

<sup>632</sup> For this purpose, excluded employees under section 414(q)(5), such as employees who are under age 21 or have not completed six months of service, are not taken into account.

<sup>633</sup> Section 199 provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) for a portion of the taxpayer’s qualified production activities income or taxable income. The amount of the deduction for a taxable year is limited to 50 percent of the Form

For this purpose, specified credits include the credit for research expenses, the Indian employment credit, the credit for employer FICA tax paid on tips, the credit for certain clinical drug testing expenses, the credit for employee health insurance expenses of small employers, the work opportunity credit, the empowerment zone employment credit, and any credit specified by the Secretary.<sup>634</sup>

### ***Reporting by large food and beverage establishments***

Under the provision, if a certified professional employer organization is treated for employment tax purposes as the employer of a work site employee, the customer for whom the work site employee performs services is the employer for purposes of the reporting required with respect to a large food or beverage establishment. The certified professional employer organization is required to furnish the customer and the Secretary with any information the Secretary prescribes as necessary to complete the required reporting. The certified professional employer organization is required to furnish the required information no later than the time the Secretary prescribes.

### ***Regulations and reporting and record-keeping requirements***

The Secretary is directed to prescribe regulations as may be necessary or appropriate to carry out the purposes of the provision.

In addition, the Secretary is directed to develop reporting and record-keeping rules, regulations and procedures as the Secretary determines necessary or appropriate to ensure tax compliance by certified professional employer organizations or persons that have been so certified. These rules are to include (1) notification of the Secretary, in the manner prescribed by the Secretary, of the commencement or termination of a qualifying service contract with a customer and the employer identification number of the customer, (2) information the Secretary determines necessary for the customer to claim specified credits and the manner in which the information is to be provided, and (3) other information as the Secretary determines is essential to promote compliance with respect to specified credits and FUTA credits. In the case of a failure to make a report containing the required information by the time required, a penalty of \$50 may apply (\$100 in the case of a failure due to negligence or intentional disregard).

The rules, regulations and procedures are to be designed in a manner that streamlines, to the extent possible, the application of the requirements of the provision, the exchange of information between a certified professional employer organization and its cus-

W-2 wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in the calendar year. For this purpose, Form W-2 wages means wages subject to income tax withholding, as well as elective deferrals and certain other amounts, that the taxpayer properly reports on Forms W-2 for the calendar year. Under regulations dealing with wages paid by an entity other than the common-law employer, a taxpayer may take into account wages paid by another entity and reported by the other entity on Form W-2 (with the other entity listed as the employer on the Form W-2), provided that the wages were paid to employees of the taxpayer for employment by the taxpayer. Treas. Reg. sec. 1.199-2(a)(2). The provision does not affect the application of these rules.

<sup>634</sup> These credits are provided, respectively, under sections 41, 45A, 45B, 45C, 45R, 51, and 1396.

tomers, and the reporting and recordkeeping obligations of the certified professional employer organization.

### ***Other rules***

#### *Disclosure*

The provision directs the Secretary to make available to the public the name and address of each person certified as a professional employer organization and each person whose certification as a professional employer organization is suspended or revoked.

#### *User fees*

Under the provision, the user fee charged under the program for certifying a professional employer organization is an annual fee and may not exceed \$1,000.

#### *No inference as to effect of provision*

Nothing contained in the provision or the amendments made by the provision is to be construed to create any inference with respect to the determination of who is an employee or employer (1) for Federal tax purposes (other than the purposes set forth in the amendments made by the provision), or (2) for purposes of any other provision of law.

### ***Effective Date***

The provision is effective with respect to wages paid for services performed on or after January 1 of the first calendar year beginning more than 12 months after the date of enactment of the provision (December 19, 2014). The Secretary is directed to establish the certification program for professional employer organizations not later than six months before the provision becomes effective.

## **C. Exclusion of Dividends From Controlled Foreign Corporations From the Definition of Personal Holding Company Income for Purposes of the Personal Holding Company Rules (sec. 207 of the Act and sec. 543 of the Code)**

### ***Present Law***

#### ***Personal holding company tax***

In addition to the regular corporate tax, an additional tax is imposed on a corporation that is a personal holding company. The tax is an amount equal to the maximum rate of tax on qualified dividends of individuals (currently 20 percent), multiplied by the corporation's undistributed personal holding company income above a dollar threshold.<sup>635</sup> A personal holding company is a closely held corporation at least 60 percent of the adjusted ordinary gross income (as defined) of which is personal holding company income.<sup>636</sup> Personal holding company income includes dividends, interest, certain rents, and other generally passive investment income.<sup>637</sup>

<sup>635</sup> Sec. 541.

<sup>636</sup> Sec. 542.

<sup>637</sup> Sec. 543.

### ***Controlled foreign corporations***

In general, the U.S. does not impose tax on the income of a foreign corporation unless and until that income is distributed to U.S. shareholders. However, the rules of subpart F<sup>638</sup> provide an exception for certain passive or readily movable income of a foreign corporation that, for a period of at least 30 days during the taxable year, is more than 50-percent owned (by voting power or value) by U.S. shareholders each of which owns at least 10 percent of the voting power of the corporate stock after applying attribution rules (a controlled foreign corporation). The pro rata share of such corporate earnings is currently included as income of the 10-percent (or greater) shareholders (by voting power) that hold their stock on the last day of the taxable year. Except as otherwise provided for specific purposes of the Code, the inclusions are not treated as dividends. When the earnings are distributed to the U.S. shareholders, they are not again subject to tax.<sup>639</sup>

When a controlled foreign corporation distributes money or other property to a U.S. shareholder out of its earnings and profits not previously included in the income of the shareholder under the rules of subpart F, the amount of money or fair market value of the property is included in gross income as a dividend.<sup>640</sup>

### ***Reasons for Change***

The Congress believed that dividends paid by a controlled foreign corporation to a 10-percent U.S. shareholder, out of the controlled foreign corporation's earnings and profits that were not treated as passive or readily movable income inclusions to the shareholder under the rules of subpart F, are attributable to active business income of the controlled foreign corporation. Accordingly, it was appropriate to exclude these dividends from personal holding company income of the shareholder.

The Congress also believed that the personal holding company tax currently deters the repatriation of earnings that would be repatriated if the U.S. corporate tax alone (but not the personal holding company tax) were applicable to the repatriated earnings.

<sup>638</sup> Secs. 951–965.

<sup>639</sup> Sec. 959. A separate set of rules applies to income of a foreign corporation that is a passive foreign investment corporation, generally defined as a foreign corporation 75 percent or more of the gross income of which is passive income, or 50 percent or more of the assets of which produce or are held for the production of passive income (sec. 1297). Such income is either subject to the highest rate of tax for ordinary income applicable to individuals and an interest charge for deferral when it is ultimately distributed to a U.S. shareholder, or an election can be made to include income currently even if not distributed (secs. 1291–1298). A corporation is not treated as a passive foreign investment corporation with respect to any U.S. shareholder during the period such corporation is a controlled foreign corporation of which the shareholder is a 10-percent or greater owner (by voting power) under the rules relating to controlled foreign corporations (sec. 1297(d)).

<sup>640</sup> A 10-percent corporate shareholder may be allowed a foreign tax credit for the foreign income taxes paid on the earnings and profits distributed as a dividend (sec. 902). Also, a dividends-received deduction is allowed to a corporate shareholder to the extent the dividend is attributable to certain U.S. source income, and no foreign tax credit is allowed with respect to any such amount. (sec. 245). A dividend received by an individual is a qualified dividend, eligible for the maximum 20-percent tax rates, if the dividend is from a qualified foreign corporation (generally, a corporation (i) that is eligible for certain treaty benefits or is incorporated in a U.S. possession, or (ii) the stock of which with respect to which the dividend is paid is readily tradable on a U.S. securities market; and that in either case is not a passive foreign investment company (sec. 1(h)(1)(C)).

### ***Explanation of Provision***

Under the provision, dividends received by a 10-percent U.S. shareholder (as defined in section 951(b)) from a controlled foreign corporation (as defined in section 957(a)) are excluded from the definition of personal holding company income for purposes of the personal holding company tax.

### ***Effective Date***

The provision applies to taxable years ending on or after the date of enactment (December 19, 2014).

### **D. Inflation Adjustment for Certain Civil Penalties Under the Internal Revenue Code (sec. 208 of the Act and secs. 6651, 6652(c), 6695, 6698, 6699, 6721, and 6722 of the Code)**

#### ***Present Law***

The Code provides for both civil and criminal penalties to ensure complete and accurate reporting of tax liability and to discourage fraudulent attempts to defeat or evade tax. Civil and criminal penalties are applied separately. Thus, a taxpayer convicted of a criminal tax offense may be subject to both criminal and civil penalties, and a taxpayer acquitted of a criminal tax offense may nonetheless be subject to civil tax penalties. In cases involving both criminal and civil penalties, the IRS generally does not pursue both simultaneously, but delays pursuit of civil penalties until the criminal proceedings have concluded.

Civil penalties are provided in Chapter 68 of the Code.<sup>641</sup> Civil penalties are categorized into two types: additions to the tax and additional amounts (herein “additions to tax”), and assessable penalties. The additions to tax are generally subject to deficiency proceedings, and some may be waived under certain circumstances, including a showing of reasonable cause.<sup>642</sup> Assessable penalties can be assessed without restrictions (such as the opportunity for preassessment judicial review) applicable in deficiency cases.<sup>643</sup> Assessable penalties may also be waived under certain circumstances, including a showing of reasonable cause.<sup>644</sup>

Some penalties are calculated by reference to the tax liability, while others are fixed dollar amounts. Penalties with a fixed dollar amount include penalties in the case of (i) failure to file a tax return or to pay tax,<sup>645</sup> (ii) failure to file certain information returns, registration statements, and certain other statements,<sup>646</sup> (iii) failure to furnish a copy of the tax return to the taxpayer, failure to sign the return, failure to furnish an identifying number, failure to retain a completed copy of the tax return or retain on a list the name and taxpayer identification number of the taxpayer for whom the return was prepared, failure to file correct information returns, negotiation of a taxpayer’s check by the tax return preparer, and

<sup>641</sup> Secs. 6651–6751.

<sup>642</sup> Secs. 6651–6663; Sec. 6664.

<sup>643</sup> Secs. 6671–6725.

<sup>644</sup> Sec. 6724.

<sup>645</sup> Sec. 6651(a).

<sup>646</sup> Sec. 6652(c).

failure to be diligent in determining eligibility for the earned income credit,<sup>647</sup> (iv) failure of a partnership to file a return,<sup>648</sup> (v) failure of an S corporation to file a return,<sup>649</sup> (vi) failure to file correct information returns,<sup>650</sup> and (vii) failure to file correct payee statements.<sup>651</sup>

The penalty provisions generally contain no automatic mechanism to adjust the amount of the penalty for inflation. However, the penalty provisions relating to the failure to file correct information returns and the failure to furnish correct payee statements are adjusted for inflation every five years and provide a rounding rule.

### ***Reasons for Change***

The Congress believed that indexing these fixed-dollar penalties would encourage compliance with the tax law. By correlating increases in the amounts to increases in other types of dollar amounts in the economy generally, the penalties can continue to serve as a meaningful economic deterrent to non-compliant behavior.

### ***Explanation of Provision***

The provision indexes the fixed-dollar civil tax penalties in the case of: (i) failure to file a tax return,<sup>652</sup> (ii) failure to file or disclose information return by exempt organizations and certain trusts,<sup>653</sup> (iii) preparation of tax returns of other persons,<sup>654</sup> (iv) failure to file partnership return,<sup>655</sup> (v) failure to file S corporation returns,<sup>656</sup> (vi) failure to file correct information return,<sup>657</sup> and (vii) failure to furnish correct payee statements.<sup>658</sup> The provision rounds penalty amounts down to the nearest multiple of five dollars if less than \$5,000, otherwise the provision rounds penalty amounts down to the nearest multiple of \$500. The provision does not modify the present-law rounding rules relating to the failure to file correct information returns and the failure to furnish correct payee statements.

### ***Effective Date***

The provision is generally effective for returns required to be filed after December 31, 2014. The amendment relating to the failure to file or disclose information returns by exempt organizations and certain trusts is effective for failures relating to returns required to be filed or disclosed after that date. The amendment relating to the preparation of tax returns of other persons is effective for failures relating to returns or claims for refund filed after that date (or, in the case of the penalty relating to the negotiation of

<sup>647</sup> Sec. 6695.

<sup>648</sup> Sec. 6698.

<sup>649</sup> Sec. 6699.

<sup>650</sup> Sec. 6721.

<sup>651</sup> Sec. 6722.

<sup>652</sup> Sec. 6651(a).

<sup>653</sup> Sec. 6652(c).

<sup>654</sup> Sec. 6695.

<sup>655</sup> Sec. 6698.

<sup>656</sup> Sec. 6699.

<sup>657</sup> Sec. 6721.

<sup>658</sup> Sec. 6722.



checks, to checks negotiated after that date). The amendment relating to the failure to furnish correct payee statements is effective for statements required to be furnished after that date.

**E. Increase Continuous Levy Authority on Payments to Medicare Providers and Suppliers (sec. 209 of the Act and sec. 6331 of the Code)**

***Present Law***

***In general***

Levy is the administrative authority of the IRS to seize a taxpayer's property, or rights to property, to pay the taxpayer's tax liability.<sup>659</sup> Generally, the IRS is entitled to seize a taxpayer's property by levy if a Federal tax lien has attached to such property,<sup>660</sup> the property is not exempt from levy,<sup>661</sup> and the IRS has provided both notice of intention to levy<sup>662</sup> and notice of the right to an administrative hearing (the notice is referred to as a "collections due process notice" or "CDP notice" and the hearing is referred to as the "CDP hearing")<sup>663</sup> at least 30 days before the levy is made. A levy on salary or wages generally is continuously in effect until released.<sup>664</sup> A Federal tax lien arises automatically when: (1) a tax assessment has been made; (2) the taxpayer has been given notice of the assessment stating the amount and demanding payment; and (3) the taxpayer has failed to pay the amount assessed within 10 days after the notice and demand.<sup>665</sup>

The notice of intent to levy is not required if the Secretary finds that collection would be jeopardized by delay. The standard for determining whether jeopardy exists is similar to the standard applicable when determining whether assessment of tax without following the normal deficiency procedures is permitted.<sup>666</sup>

The CDP notice (and pre-levy CDP hearing) is not required if: (1) the Secretary finds that collection would be jeopardized by delay; (2) the Secretary has served a levy on a State to collect a Federal tax liability from a State tax refund; (3) the taxpayer subject to the levy requested a CDP hearing with respect to unpaid employment taxes arising in the two-year period before the beginning of the taxable period with respect to which the employment tax levy is served; or (4) the Secretary has served a Federal contractor levy. In each of these four cases, however, the taxpayer is provided an opportunity for a hearing within a reasonable period of time after the levy.<sup>667</sup>

<sup>659</sup> Sec. 6331(a). Levy specifically refers to the legal process by which the IRS orders a third party to turn over property in its possession that belongs to the delinquent taxpayer named in a notice of levy.

<sup>660</sup> Ibid.

<sup>661</sup> Sec. 6334.

<sup>662</sup> Sec. 6331(d).

<sup>663</sup> Sec. 6330. The notice and the hearing are referred to collectively as the CDP requirements.

<sup>664</sup> Secs. 6331(e) and 6343.

<sup>665</sup> Sec. 6321.

<sup>666</sup> Secs. 6331(d)(3), 6861.

<sup>667</sup> Sec. 6330(f).

### ***Federal payment levy program***

To help the IRS collect taxes more effectively, the Taxpayer Relief Act of 1997<sup>668</sup> authorized the establishment of the Federal Payment Levy Program (“FPLP”), which allows the IRS to continuously levy up to 15 percent of certain “specified payments” by the Federal government if the payees are delinquent on their tax obligations. With respect to payments to vendors of goods, services, or property sold or leased to the Federal government, the continuous levy may be up to 100 percent of each payment.<sup>669</sup> For payments to Medicare providers and suppliers, the levy is up to 15 percent. The levy (either up to 15 percent or up to 100 percent) generally continues in effect until the liability is paid or the IRS releases the levy.

Under FPLP, the IRS matches its accounts receivable records with Federal payment records maintained by Treasury’s Bureau of Fiscal Service (“BFS”), such as certain Social Security benefit and Federal wage records. When these records match, the delinquent taxpayer is provided both the notice of intention to levy and the CDP notice. If the taxpayer does not respond after 30 days, the IRS can instruct BFS to levy the taxpayer’s Federal payments. Subsequent payments are continuously levied until such time that the tax debt is paid or the IRS releases the levy.

### ***Reasons for Change***

It has been reported that many thousands of Medicare providers and suppliers have outstanding Federal employment and income tax liability.<sup>670</sup> Consequently, the Congress believed that it was appropriate to increase the permissible percentage of payments to a Medicare provider subject to levy.

### ***Explanation of Provision***

The provision allows the Secretary to levy up to 30 percent of a payment to Medicare providers and suppliers to collect unpaid taxes.

### ***Effective Date***

The provision is effective for payments made after 180 days after the date of enactment (December 19, 2014).

<sup>668</sup> Pub. L. No. 105–34.

<sup>669</sup> Sec. 6331(h)(3).

<sup>670</sup> Government Accountability Office, *Medicare: Thousands of Medicare Providers Abuse the Federal Tax System* (GAO–08–618), June 13, 2008.

**APPENDIX: ESTIMATED BUDGET EFFECTS OF TAX  
LEGISLATION ENACTED IN THE 113TH CONGRESS**

## Fiscal Years 2013- 2024

[Millions of Dollars]

[illegible]

[illegible]

Provision	Effective	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2013-24
<b>PART TWELVE: THE TAX INCREASE PREVENTION ACT OF 2014 AND THE STEPHEN BECK, JR. ACHIEVING A BETTER LIFE EXPERIENCE ACT OF 2014 (Public Law 113-298, signed into law by the President on December 19, 2014)</b>														
<b>Division A - Tax Increase Prevention Act of 2014</b>														
<b>I. Certain Expiring Provisions</b>														
<b>A. Subtitle A - Individual Tax Extenders</b>														
1. Above-the-line deduction of up to \$250 for teacher classroom expenses (sunset 12/31/14).....	tyba 12/31/13	---	---	-214	---	---	---	---	---	---	---	---	---	-214
2. Discharge of indebtedness on principal residence excluded from gross income of individuals (sunset 12/31/14).....	doia 12/31/13	---	---	-3,143	---	---	---	---	---	---	---	---	---	-3,143
3. Parity for exclusion from income for employer-provided mass transit and parking benefits (sunset 12/31/14) [18].....	ma 12/31/13	---	---	-10	---	---	---	---	---	---	---	---	---	-10
4. Mortgage insurance premiums treated as qualified residence interest (sunset 12/31/14).....	apoua 12/31/13	---	---	-919	---	---	---	---	---	---	---	---	---	-919
5. Deduction for State and local general sales taxes (sunset 12/31/14).....	tyba 12/31/13	---	---	-2,924	-218	---	---	---	---	---	---	---	---	-3,142
6. Contributions of capital gain and property made for conservation purposes (sunset 12/31/14).....	ami tyba 12/31/13	---	---	-60	-10	-1	-1	-6	-14	-11	-10	-9	-8	-129
7. Above-the-line deduction for qualified tuition and related expenses (sunset 12/31/14).....	tyba 12/31/13	---	---	-300	---	---	---	---	---	---	---	---	---	-300
8. Tax-free distributions from IRAs to certain public charities for individuals age 70-12 or older, not to exceed \$100,000 per taxpayer per year (sunset 12/31/14).....	dmi tyba 12/31/13	---	---	-239	-12	-13	-15	-16	-16	-17	-18	-18	-19	-384
<b>B. Subtitle B - Business Tax Extenders</b>														
1. Research credit (sunset 12/31/14).....	apoua 12/31/13	---	---	-3,786	-634	-554	-489	-432	-382	-359	-347	-336	-309	-7,629
2. Minimum LHTC rate for non-Federally subsidized new buildings (9%) (sunset 12/31/14).....	1/1/14	---	---	[4]	[4]	[4]	[4]	---	---	---	---	---	---	[4]
3. Military housing allowance exclusion for determining area median gross income (sunset 12/31/14).....	do/a 1/1/14	---	---	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
4. Indian employment tax credit (sunset 12/31/14).....	tyba 12/31/13	---	---	-51	-9	-1	---	---	---	---	---	---	---	-62
5. New markets tax credit (sunset 12/31/14).....	cyba 12/31/13	---	---	-5	-22	-68	-103	-119	-134	-145	-143	-124	-116	-978
6. Railroad track maintenance credit (sunset 12/31/14).....	apou tyba 12/31/13	---	---	-207	[4]	---	---	---	---	---	---	---	---	-207
7. Mine rescue team training credit (sunset 12/31/14).....	tyba 12/31/13	---	---	-2	[4]	[4]	[4]	[4]	---	---	---	---	---	-3
8. Employer credit for activated military reservists (sunset 12/31/14).....	ppia 12/31/13	---	---	-1	---	---	---	---	---	---	---	---	---	-1
9. Work opportunity tax credit (sunset 12/31/14).....	tyba 12/31/13	---	---	-981	-226	-92	-50	-23	-4	---	---	---	---	-1,375
10. Qualified zone academy bonds (sunset 12/31/14).....	oa 12/31/13 & [19]	---	---	-1	-6	-13	-17	-16	-16	-15	-15	-14	-14	-126
11. Classification of certain race horses as 2-year property (sunset 12/31/14).....	ppia 12/31/13	---	---	-74	-22	10	18	22	22	17	6	---	---	---
12. 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements (sunset 12/31/14) [20].....	ppia 12/31/13	---	---	-265	-263	-259	-254	-240	-232	-236	-230	-221	-181	-2,382
13. 7-year recovery period for motorports entertainment complexes (sunset 12/31/14) [21].....	ppia 12/31/13	---	---	-11	-9	-6	-4	-3	-3	-2	1	2	1	-33
14. Accelerated depreciation for business property on an Indian reservation (sunset 12/31/14).....	ppia 12/31/13	---	---	-153	-37	6	25	39	32	16	[17]	-5	-3	-79
15. Bonus depreciation:														
a. Additional first-year depreciation for 50% of basis of qualified property (sunset 12/31/14) [22].....	ppia 12/31/13 1/2-year	---	---	-45,270	16,242	9,838	7,085	5,217	2,973	1,517	652	280	254	-1,210
b. Election to accelerate AHT credit in lieu of bonus depreciation (sunset 12/31/14).....	ppia 12/31/13 1/2-year	---	---	-246	-31	[4]	-1	-1	-1	-1	[4]	[4]	[4]	-282

Provision	Effective	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2013-24
16. Enhanced charitable deduction for contributions of food inventory (sunset 12/31/14).....	cma 12/31/13	---	---	-143	---	---	---	---	---	---	---	---	---	-143
17. Increased expensing limitations and treatment of certain real property as section 179 property (sunset 12/31/14).....	tyba 12/31/13	---	---	-11,638	3,788	2,257	1,000	1,204	692	347	167	77	72	-1,434
18. Election to expense mine safety equipment (sunset 12/31/14).....	ppisa 12/31/13	---	---	-13	4	3	2	2	2	1	[4]	---	---	---
19. Special expensing rules for certain film and television productions (sunset 12/31/14).....	pea 12/31/13	---	---	-245	52	58	32	23	19	16	13	13	13	-6
20. Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (sunset 12/31/14).....	tyba 12/31/13	---	---	-109	---	---	---	---	---	---	---	---	---	-109
21. Modification of tax treatment of certain payments under existing arrangements to controlling exempt organizations (sunset 12/31/14).....	proaa 12/31/13	---	---	-18	---	---	---	---	---	---	---	---	---	-18
22. Treatment of certain dividends of RICs (sunset 12/31/14).....	[25]	---	---	-97	---	---	---	---	---	---	---	---	---	-97
23. Treatment of RICs as "qualified investment entities" under section 897 (FIRPTA) (sunset 12/31/14).....	1/1/14	---	---	-44	---	---	---	---	---	---	---	---	---	-44
24. Exception under subpart F for active financing income (sunset 12/31/14).....	[24]	---	---	-5,082	---	---	---	---	---	---	---	---	---	-5,082
25. Look-through treatment of payments between related CFCs under foreign personal holding company income rules (sunset 12/31/14).....	[24]	---	---	-1,154	---	---	---	---	---	---	---	---	---	-1,154
26. Exclusion of 100 percent of gain on certain small business stock (sunset 12/31/14).....	saa 12/31/13	---	---	14	---	---	---	-134	-761	---	---	---	---	-881
27. Basis adjustment to stock of S corporations holding charitable contributions of property (sunset 12/31/14).....	ami tyba 12/31/13	---	---	-49	-2	---	---	---	---	---	---	---	---	-51
28. Reduction in corporate tax credit period for built-in gain tax credit (12/31/14).....	tyba 12/31/13	---	---	-82	-3	-4	-2	-1	-1	-1	---	---	---	-94
29. Empowerment zone tax incentives (sunset 12/31/14).....	pa 12/31/13	---	---	-212	-18	-8	-3	-1	-1	-2	-2	-2	-1	-251
30. Temporary increase in limit on cover over of rum excise tax revenues (from \$10.50 to \$13.25 per proof gallon) to Puerto Rico and the Virgin Islands (sunset 12/31/14) [1] [25].....	abluSa 12/31/13	---	---	-168	---	---	---	---	---	---	---	---	---	-168
31. American Samoa economic development credit (sunset 12/31/14).....	tyba 12/31/13	---	---	-14	---	---	---	---	---	---	---	---	---	-14
C. Subtitle C - Energy Tax Extenders														
1. Credit for section 25C nonbusiness energy property (sunset 12/31/14).....	ppisa 12/31/13	---	---	-832	[4]	---	---	---	---	---	---	---	---	-832
2. Second generation biofuel producer credit (sunset 12/31/14).....	fpa 12/31/13	---	---	-25	---	---	---	---	---	---	---	---	---	-25
3. Incentives for biodiesel and renewable diesel: a. Income tax credits for biodiesel fuel, biodiesel used to produce a qualified mixture, and small agri-biodiesel producers (sunset 12/31/14).....	saaa 12/31/13	---	---	-1,297	---	---	---	---	---	---	---	---	---	-1,297
b. Income tax credits for renewable diesel fuel and renewable diesel used to produce a qualified mixture (sunset 12/31/14).....	saaa 12/31/13	---	---	-1,297	---	---	---	---	---	---	---	---	---	-1,297
4. Credit for the production of Indian coal (sunset 12/31/14).....	qpa 12/31/13	---	---	-31	-3	-2	-1	-1	[4]	---	---	---	---	-38
5. Beginning-of-construction date for renewable power facilities eligible to claim the electricity production credit or investment credit in lieu of the production credit (sunset 12/31/14).....	1/1/14	---	---	-191	-178	-391	-585	-699	-779	-831	-884	-915	-939	-6,392

Estimate included in Item 1.C.3.a of Part Twelve

Provision	Effective	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2013-24
6. Credit for construction of energy-efficient new homes (sumset 12/31/14).....	hsa 12/31/13	---	---	-164	-25	-22	-20	-17	-14	-5	---	---	---	-267
7. Special allowance for second generation biofuel plant property (sumset 12/31/14).....	ppsa 12/31/13	---	---	-4	[17]	[17]	[17]	[17]	[17]	[17]	[17]	[17]	[17]	[4]
8. Energy efficient commercial buildings deduction (sumset 12/31/14).....	ppsa 12/31/13	---	---	-144	3	3	3	2	2	2	1	1	1	-127
9. Special rule for sales or dispositions to implement Federal Energy Regulatory Commission ("FERC") or State electric restructuring policy for qualified electric utilities (sumset 12/31/14).....	da 12/31/13	---	---	-324	51	51	51	51	51	18	---	---	---	---
10. Excise tax credits relating to certain fuels:														
a. Excise tax credits and outlay payments for alternative fuel, and excise tax credits for alternative fuel mixtures (including extensions for liquefied hydrogen) (sumset 12/31/14).....	fsaa 12/31/13 & fsaa 9/30/14	---	---	-397	---	---	---	---	---	---	---	---	---	-397
b. Excise tax credits and outlay payments for renewable diesel fuel mixtures (sumset 12/31/14).....	saa 12/31/13	---	---	---	---	---	---	---	---	---	---	---	---	---
c. Excise tax credits and outlay payments for renewable diesel fuel mixtures (sumset 12/31/14).....	saa 12/31/13	---	---	-38	-2	-1	[17]	[17]	[17]	[17]	[17]	[17]	[17]	-41
11. Alternative fuel vehicle reducing property (non-hydrogen) (sumset 12/31/14).....	ppsa 12/31/13	---	---	---	---	---	---	---	---	---	---	---	---	---
D. Subtitle D - Extenders Relating to Multiemployer Defined Benefit Pension Plans [26].....	---	---	---	---	---	---	---	---	---	---	---	---	---	---
II. Technical Corrections.....	[27]	---	---	---	---	---	---	---	---	---	---	---	---	---
III. Joint Committee on Taxation														
A. Increased Refund and Credit Threshold for Joint Committee on Taxation Review of C Corporation Return.....	DOE	---	---	---	---	---	---	---	---	---	---	---	---	---
Total of Division A - Tax Increase Prevention Act of 2014.....		---	---	-81,364	18,410	10,791	7,272	4,851	1,456	341	-791	-1,271	-1,248	-41,571
Division B - The Stephen Beck, Jr. Achieving a Better Life Experience Act of 2014 (The Stephen Beck, Jr. ABLE Act of 2014)														
I. Qualified ABLE Programs														
A. Create a New Type of Tax-Favored Account ("ABLE Account") For the Benefit of an Individual Diagnosed Before Age 26 as Being Disabled.....	generally tba 12/31/14	---	---	-1	-4	-10	-24	-49	-82	-117	-158	-203	-249	-898
B. Extension of ABLE Accounts Under Certain Federal Programs [28].....	DOE	---	---	-1	-12	-31	-47	-78	-109	-150	-202	-243	-280	-1,153
C. Treatment of ABLE Accounts in Bankruptcy.....	[29]	---	---	---	---	---	---	---	---	---	---	---	---	---
D. Investment Discretion Rule for 529 Plans.....	tba 12/31/14	---	---	---	---	---	---	---	---	---	---	---	---	---
II. Offsets														
A. Correction to Workers Compensation Offset Age [30] [31].....	[32]	---	---	---	5	15	20	20	20	25	30	40	45	220
B. Accelerated Application of Relative Value Targets for Minvalued Services in the Medicare Physician Fee Schedule [28] [31].....	DOE	---	---	---	104	218	231	151	-10	-74	-84	-85	-84	365
C. Consistent Treatment of Vacuum Erection Systems in Medicare Parts B and D [28] [31].....	iasfoa 7/1/15	---	---	9	40	41	41	45	48	51	56	56	57	444
D. One-Year Delay of Implementation of Oral-Only Policy Under Medicare End Stage Renal Disease Prospective Payment System [28] [31].....	DOE	---	---	---	---	---	---	---	---	---	---	---	---	380
E. Independent Payment Advisory Board Interaction [28] [31].....	---	---	---	---	---	---	---	---	---	---	10	22	4	37
F. Modification Relating to Inland Waterways Trust Fund Financing Rate (25 Cents Per Gallon).....	b/a 4/1/15	---	---	13	28	28	28	28	28	27	27	27	27	260



Provision	Effective	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2013-24
G. Certified Professional Employer Organizations.....	[33]	---	---	---	2	1	1	1	1	1	1	[17]	[17]	8
H. Exclusion of Dividends from Controlled Foreign Corporations from the Definition of Personal Holding Company Income for Purposes of the Personal Holding Company Rules.....	tyeo/a DOE	---	---	[17]	1	1	1	1	2	2	2	2	2	14
I. Inflation Adjustment for Certain Civil Tax Penalties Under the Internal Revenue Code.....	rtb/a 12/31/14	---	---	---	1	2	4	6	9	12	15	18	21	115
J. 30 Percent Continuous Levy Authority on Payment to Medicare Providers and Suppliers.....	pma 180da DOE	---	---	7	24	25	25	26	26	27	27	28	28	241
Total of Division B - The Stephen Beck, Jr. ABLE Act of 2014.....		---	---	28	190	292	282	154	-64	-193	-273	-335	-45	33
<b>TOTAL OF PART TWELVE.....</b>		---	---	-81,336	18,600	11,084	7,554	5,005	1,372	148	-1,063	-1,606	-1,293	-41,539

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column:

abt/usa = articles brought into the United States after  
 apoa/a = amounts paid or accrued after  
 apoa = amounts paid or incurred after  
 cma = contributions made after  
 cmt = contributions made in  
 cpa = coal produced after  
 cy/a = calendar years beginning after  
 da = dispositions after  
 dnt = distributions made in  
 DOE = date of enactment  
 dole = discharge of indebtedness after  
 epoi = expenses paid or incurred in

fva = fuel produced after  
 fova = fuel sold or used after  
 fova = fuel used on or after  
 haa = homes acquired after  
 lasfoaa = items and services furnished on and after  
 ida/a = income determinations on or after  
 tyasda = in taxable years ending after such date  
 twtwf/a = individuals who begin work for the employer after  
 ma = months after  
 oia = obligations issued after  
 pa = periods after  
 pea = productions commencing after  
 pma = payments made after  
 pma/a = property placed in service after  
 pva/a = payments received or accrued after  
 pva = plan years beginning after  
 rtb/a = returns required to be filed after  
 saa = stock acquired after  
 saa = sales and uses after  
 ty/a = taxable years beginning after  
 tyso/a = taxable years ending on or after  
 180da = 180 days after  
 y/a = years beginning after

[1] This bill is estimated to have no outlay effect, as provided by the Congressional Budget Office.

[2] Generally effective on the later of the first day of the first month which begins more than four weeks after the date of enactment or the date on which the Secretary of Health and Human Services lists any vaccine against seasonal influenza (other than any such vaccine listed by the Secretary prior to the date of enactment).

[3] Effective for payments made on or after December 24, 2012, and before the later of January 1, 2014, or the date which is 30 days after the date of enactment.

[4] Loss of less than \$500,000.

[5] This estimate includes the effects of PBO/C premium changes, which are provided by the Congressional Budget Office.

Estimate includes the following budget effects:

Estimate includes the following budget effects:														
On-budget effects.....	5	8	4	2	5	10	14	21	29	36	42	176	2013-24	
Off-budget effects.....	---	---	---	---	---	---	---	---	---	---	---	---	---	
[6] Estimate includes the following budget effects:														
Total Revenue Effect.....	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2013-24	
On-budget effects.....	749	2,717	4,136	4,551	3,872	2,015	23	-1,758	-3,321	-4,052	-3,779	-3,877	5,152	
Off-budget effects.....	725	2,591	3,952	4,354	3,717	1,946	36	-1,608	-3,166	-3,877	-3,622	-4,988	4,988	
Direct spending effects.....	24	127	184	198	155	69	-14	-91	-155	-155	-176	-164	164	
Off-budget effects.....	---	---	---	---	---	---	---	---	---	---	---	---	---	
Direct spending effects [34].....	---	---	---	---	---	---	---	---	---	---	---	---	---	
Estimate provided by the Congressional Budget Office:														
before the end of the one-year period beginning on the date of enactment.														
[9] Estimate includes the following off-budget effects.....	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2013-24	
[10] Generally effective for plans issued or renewed on or after July 1, 2013; effective with respect to exception from ACA section 9010 beginning in calendar year 2014.	---	---	---	---	---	---	---	---	---	---	---	---	---	

[7] Estimate provided by the Congressional Budget Office.

[8] Effective for taxable years for which the tribal member's refund statute of limitations period has not expired, and provides a one-year waiver of the refund statute of limitations period in the event that the period expires before the end of the one-year period beginning on the date of enactment.

[9] Estimate includes the following off-budget effects.....

[10] Generally effective for plans issued or renewed on or after July 1, 2013; effective with respect to exception from ACA section 9010 beginning in calendar year 2014.

[Provisions for the Appendix are continued on the following page.]

